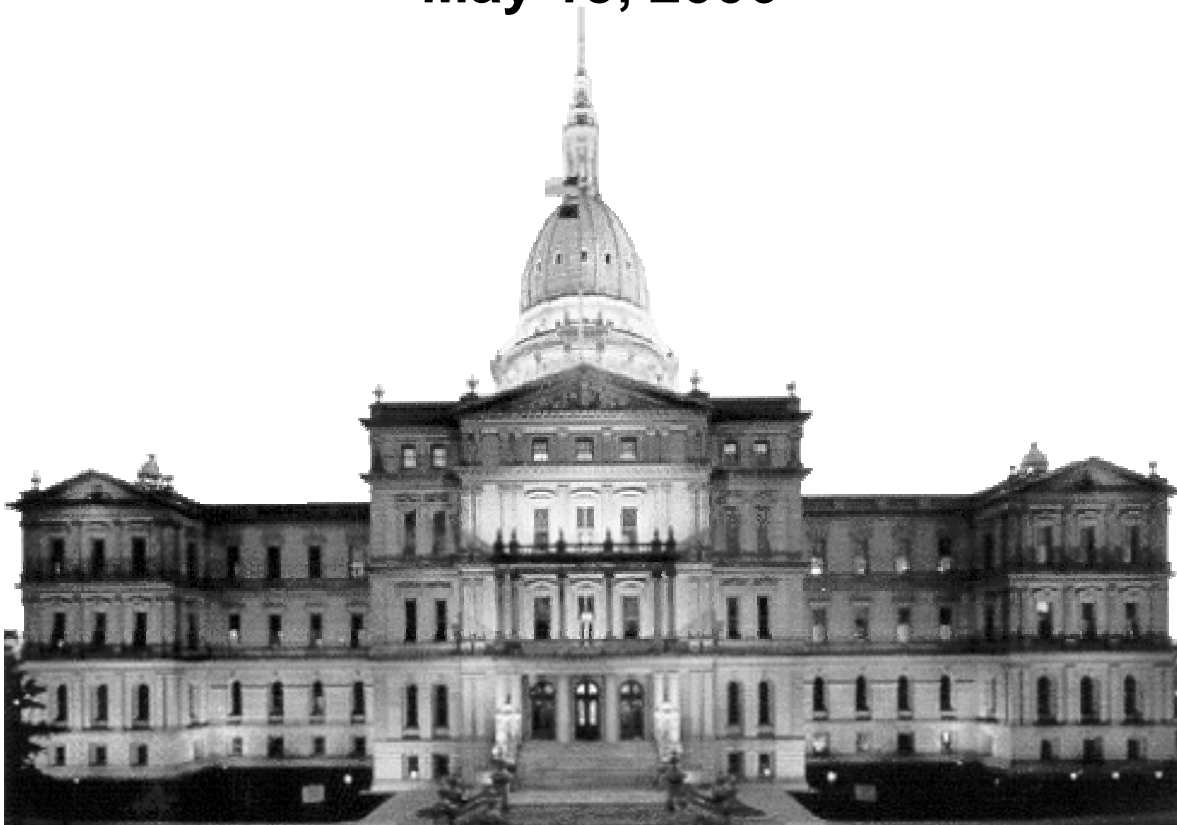




**MICHIGAN'S
ECONOMIC OUTLOOK
AND BUDGET REVIEW**

FY 2005-06 AND FY 2006-07

May 15, 2006



THE SENATE FISCAL AGENCY

The Senate Fiscal Agency is governed by a board of five members, including the majority and minority leaders of the Senate, the Chairperson of the Appropriations Committee of the Senate, and two other members of the Appropriations Committee of the Senate appointed by the Chairperson of the Appropriations Committee with the concurrence of the Majority Leader of the Senate, one from the minority party.

The purpose of the Agency, as defined by statute, is to be of service to the Senate Appropriations Committee and other members of the Senate. In accordance with this charge, the Agency strives to achieve the following objectives:

1. To provide technical, analytical, and preparatory support for all appropriations bills.
2. To provide written analyses of all Senate bills, House bills, and Administrative Rules considered by the Senate.
3. To review and evaluate proposed and existing State programs and services.
4. To provide economic and revenue analysis and forecasting.
5. To review and evaluate the impact of Federal budget decisions on the State.
6. To review and evaluate State issuance of long-term and short-term debt.
7. To review and evaluate the State's compliance with constitutional and statutory fiscal requirements.
8. To prepare special reports on fiscal issues as they arise and at the request of members of the Senate.

The Agency is located on the 8th floor of the Victor Office Center. The Agency is an equal opportunity employer.



Gary S. Olson, Director
Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536
Telephone (517) 373-2768; TDD (517) 373-0543
Internet Home Page <http://www.senate.michigan.gov/sfa>

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This Economic Outlook and Budget Review was prepared and written by Gary S. Olson, Director, Jay Wortley, Senior Economist, and David Zin, Economist, of the Senate Fiscal Agency. Karen Hendrick, Executive Secretary, coordinated the production of this report.

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EXECUTIVE SUMMARY

ECONOMIC FORECAST

The U.S. economy, as measured by inflation-adjusted gross domestic product, is predicted to grow 3.6% in 2006 and 2.9% in 2007. Light vehicle sales are forecasted to decline slightly to 16.7 million units in 2006 before rising to 16.8 million units in 2007. The unemployment rate is expected to average 4.7% in 2006 and 4.9% in 2007, while the consumer price index is estimated to rise 3.0% in 2006 and 2.6% in 2007.

The Michigan economy, as measured by inflation-adjusted personal income, is estimated to increase 0.9% in 2006 and 1.7% in 2007. Wage and salary employment is predicted to decline 0.9% in 2006 and 0.4% in 2007.

REVENUE FORECAST

In fiscal year (FY) 2005-06, General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue will total an estimated \$19.5 billion, which represents a 1.3% increase from FY 2004-05. This revised estimate is up \$19.7 million from the January 2006 consensus estimate. General Fund/General Purpose revenue will decline an estimated 0.5% to \$8.3 billion and SAF revenue will increase an estimated 2.6% to \$11.2 billion. Compared with the January 2006 consensus estimates, the GF/GP revenue estimate is up \$53.4 million and the SAF revenue estimate is down \$33.7 million.

In FY 2006-07, GF/GP and SAF revenue is expected to increase 2.7% to \$20.0 billion. General Fund/General Purpose revenue will increase to an estimated \$8.4 billion, which is up 2.0% from the revised FY 2005-06 estimate, and SAF revenue will increase an estimated 3.1% to \$11.6 billion. The GF/GP revised estimate is up \$51.3 million from January, while the SAF revised estimate is down \$44.2 million.

YEAR-END BALANCE ESTIMATES

Based on the Senate Fiscal Agency's (SFA's) revised estimates of FY 2005-06 revenue and actual and projected State appropriations, the SFA now believes that the FY 2005-06 GF/GP budget is in surplus by \$117.4 million. A comparison of the SFA's FY 2005-06 School Aid Fund revenue estimate with enacted appropriations leads to a surplus of \$88.1 million.

Comparing the FY 2006-07 revenue estimate along with the Governor's recommendation for revenue adjustments and appropriations leads to a projected FY 2006-07 GF/GP year-end balance of \$78.8 million. Comparing the FY 2006-07 School Aid Fund revenue estimate along with the Governor's recommendations for revenue adjustments and appropriations leads to a projected \$36.3 million deficit.

EXECUTIVE SUMMARY

SENATE FISCAL AGENCY ECONOMIC AND BUDGET SUMMARY

ECONOMIC PROJECTIONS (Calendar Year)				
	2004 Actual	2005 Actual	2006 Estimate	2007 Estimate
Real Gross Domestic Product (% change).....	4.2%	3.6%	3.6%	2.9%
U.S. Consumer Price Index (% change)	2.7%	3.4%	3.0%	2.6%
Light Motor Vehicle Sales (millions of units).....	16.9	16.9	16.7	16.8
U.S. Unemployment Rate (%)	5.5%	5.1%	4.7%	4.9%
Real Michigan Personal Income (% change)	0.2%	0.5%	0.9%	1.7%
Michigan Wage & Salary Employment (% change)	(0.3)%	(0.2)%	(0.9)%	(0.4)%

REVENUE ESTIMATES GENERAL FUND/GENERAL PURPOSE (GF/GP) AND SCHOOL AID FUND (SAF) (Millions of Dollars)						
	<u>FY 2005-06 Estimate</u>			<u>FY 2006-07 Estimate</u>		
	Baseline	Tax Changes	Net Available	Baseline	Tax Changes	Net Available
Gen'l Fund/Gen'l Purpose	\$8,290.0	\$(28.8)	\$8,261.2	\$8,488.3	\$(59.8)	\$8,428.4
% Change	1.6%	---	(0.5)%	2.4%	---	2.0%
School Aid Fund	\$11,172.1	\$25.2	\$11,197.3	\$11,524.1	\$22.8	\$11,546.9
% Change	2.4%	---	2.6%	3.2%	---	3.1%
Total GF/GP and SAF	\$19,462.1	\$(3.6)	\$19,458.5	\$20,012.4	\$(37.0)	\$19,975.4
% Change	2.0%	---	1.3%	2.8%	---	2.7%
Revenue Limit - Under (Over):	<u>FY 2005-06 Estimate</u> \$4,686.0			<u>FY 2006-07 Estimate</u> \$4,929.0		

YEAR-END BALANCE ESTIMATES (Fiscal Year, Millions of Dollars)			
	<u>FY 2004-05 Actual</u>	<u>FY 2005-06 Estimate</u>	<u>FY 2006-07 Estimate</u>
General Fund/General Purpose	\$220.5	\$117.4	\$78.8
School Aid Fund	\$93.7	\$88.1	\$(36.3)
Budget Stabilization Fund.....	\$2.0	\$2.1	\$2.2

ECONOMIC REVIEW AND OUTLOOK

State revenue, particularly tax revenue, depends heavily on economic conditions. This section presents the Senate Fiscal Agency's latest economic forecast for 2006 and 2007, as well as a summary of recent economic activity.

RECENT ECONOMIC HIGHLIGHTS

The first quarter of 2006 marked the 18th consecutive quarter of growth in inflation-adjusted Gross Domestic Product (GDP), and the 11th consecutive quarter in which GDP rose at a rate of at least 3.3%. Despite the strength in GDP growth, employment gains have been hampered by sustained increases in productivity and a variety of other economic shocks, particularly in energy prices. Inflation-adjusted GDP grew 3.5% in 2005, after rising 4.2% (the third-highest rate since 1984) during 2004. In comparison, wage and salary employment rose 1.1% in 2004, less than in any year during the 1984-2000 period other than the recession years of 1991 and 1992, and only 1.5% in 2005. Details for selected economic indicators for the last few years are presented in [Table 1](#) and [Table 2](#).

Michigan's gains in personal income and employment have lagged behind every or nearly every other state in the country. The reason Michigan has struggled so much compared with other states reflects the economic changes occurring in certain sectors of the economy combined with Michigan's industrial mix. Nationally, job losses during the recession were more severe, compared with the drop in inflation-adjusted GDP, than during previous recessions primarily because of substantial increases in productivity, particularly productivity gains in the manufacturing sector. Similarly, job growth during the recovery has been slowed by continued high productivity. As seen in [Figure 1](#), productivity has been increasing rapidly in recent years, particularly in durable goods manufacturing, a sector in which Michigan industry is disproportionately concentrated ([Figures 2](#) and [3](#)).

Productivity gains provide a number of positive economic benefits, including lower product prices and greater income growth in the future. However, productivity offers a transitory negative economic effect with its impact on job growth. For example, with stable sales, an 8% increase in productivity in one year (such as experienced in durable goods manufacturing over the 2002-2003 period) means that a firm could reduce its labor force by 8% that year and still produce the output needed to meet demand. In the case of Michigan's largest industry--transportation equipment manufacturing--total sales of light vehicles have remained fairly flat (rising 0.5% in 2005) and for the "Big 3" domestic manufacturers (DaimlerChrysler, Ford and General Motors), vehicle sales have comprised a decreasing share of total U.S. sales (from 65.6% in 2000 to 56.9% in 2005). In 2001, the year the U.S. economy mostly spent in recession, Michigan represented 3.2% of the national economy, yet produced 5.2% of manufacturing goods and 6.9% of durable goods. Transportation equipment manufacturing comprises approximately one-half of Michigan's durable goods manufacturing employment and Michigan's motor vehicle manufacturing employment comprises nearly one-third of the nation's motor vehicle manufacturing employment.

While more difficult to quantify, many of Michigan's nonmanufacturing sectors rely heavily, either directly or indirectly, on activity in the motor vehicle sector. Average wages in transportation equipment manufacturing are higher than in any other economic sector in Michigan, workers in the transportation equipment manufacturing sector purchase goods and services across the spectrum for their own consumption, and vehicle manufacturers are significant consumers of a variety of goods and services as well. In 2004, wages and salaries paid to workers in the motor vehicle manufacturing sector comprised 1.1% of wages and salaries paid nationally, but 9.7% of wages

and salaries paid in Michigan. As a result, economic downturns (either from declining employment or from declining business profits) in the vehicle sector are transmitted and multiplied throughout the Michigan economy, just as any national or local economic shock is transmitted through the affected economies.

Table 1

THE SENATE FISCAL AGENCY ECONOMIC FORECAST (Calendar Years)					
<u>United States</u>	2003 Actual	2004 Actual	2005 Actual	2006 Estimate	2007 Estimate
Nominal GDP					
(year-to-year growth)	4.8%	7.0%	6.4%	6.6%	5.8%
Inflation-adjusted GDP					
(year-to-year growth)	2.7%	4.2%	3.6%	3.6%	2.9%
Unemployment rate	6.0%	5.5%	5.1%	4.7%	4.9%
Inflation					
Consumer Price Index					
(year-to-year growth)	2.3%	2.7%	3.4%	3.0%	2.6%
GDP Implicit price deflator					
(year-to-year growth)	2.0%	2.6%	2.8%	2.9%	2.8%
Interest rates					
90-day Treasury bill	1.01%	1.37%	3.15%	4.75%	5.08%
Corporate Aaa bond	5.66%	5.63%	5.23%	5.96%	6.61%
Federal funds rate	1.13%	1.35%	3.22%	5.04%	5.66%
Light motor vehicle sales					
(millions of units)	16.6	16.9	16.9	16.7	16.8
Auto	7.6	7.5	7.7	7.7	7.7
Truck	9.0	9.4	9.3	9.0	9.1
Import Share	19.9%	20.2%	20.1%	21.4%	23.4%
<u>Michigan</u>					
Personal Income (millions)	\$318,283	\$324,134	\$335,164	\$348,987	\$363,657
Year-to-year growth	4.9%	1.8%	3.4%	4.1%	4.2%
Inflation-adjusted personal income (year-to-year growth)	2.8%	0.2%	0.5%	0.9%	1.7%
Wage & salary income (millions)	\$176,652	\$180,252	\$186,722	\$190,547	\$195,959
year-to-year growth	1.8%	2.0%	3.6%	2.0%	2.8%
Detroit Consumer Price Index (year-to-year growth)	2.0%	1.6%	2.9%	3.2%	2.4%
Wage & Salary Employment (thousands)	4,409.6	4,394.7	4,384.0	4,346.1	4,326.7
year-to-year growth	(1.5)%	(0.3)%	(0.2)%	(0.9)%	(0.4)%
Unemployment Rate	7.1%	7.0%	6.7%	6.8%	6.7%

Table 2

THE SENATE FISCAL AGENCY U.S. ECONOMIC FORECAST DETAIL (Calendar Years)					
	2003 Actual	2004 Actual	2005 Actual	2006 Estimate	2007 Estimate
Gross Domestic Product (billions of dollars)	\$10,971.2	\$11,734.3	\$12,487.1	\$13,306.9	\$14,079.5
Year-to-year growth	4.8%	7.0%	6.4%	6.6%	5.8%
<i><u>Inflation-Adjusted GDP and Components</u></i>					
Gross Domestic Product (billions of 2000 dollars)	\$10,320.6	\$10,755.7	\$11,143.8	\$11,540.4	\$11,877.7
Year-to-year growth	2.7%	4.2%	3.6%	3.6%	2.9%
Consumption (billions of 2000 dollars)	\$7,306.6	\$7,588.6	\$7,856.9	\$8,137.2	\$8,412.4
Year-to-year growth	2.9%	3.9%	3.5%	3.6%	3.4%
Business fixed investment (billions of 2000 dollars)	\$1,085.0	\$1,186.7	\$1,289.0	\$1,399.8	\$1,511.9
Year-to-year growth	1.3%	9.4%	8.6%	8.6%	8.0%
Change in Business Inventories (billions of 2000 dollars)	\$15.5	\$52.0	\$20.3	\$37.2	\$35.2
Residential investment (billions of 2000 dollars)	\$509.4	\$561.8	\$601.9	\$593.9	\$541.2
Year-to-year growth	8.4%	10.3%	7.1%	(1.3)%	(8.9)%
Government spending (billions of 2000 dollars)	\$1,911.1	\$1,952.3	\$1,987.1	\$2,031.2	\$2,052.0
Year-to-year growth	2.8%	2.2%	1.8%	2.2%	1.0%
Net Exports (billions of 2000 dollars)	\$(521.4)	\$(601.3)	\$(633.0)	\$(670.3)	\$(664.4)
Exports (billions of 2000 dollars)	\$1,031.2	\$1,117.9	\$1,195.3	\$1,294.6	\$1,404.0
Imports (billions of 2000 dollars)	\$1,552.6	\$1,719.2	\$1,828.3	\$1,964.9	\$2,068.5
Personal income (year-to-year growth)	3.2%	5.9%	5.5%	6.7%	5.9%
Adjusted for Inflation	0.9%	3.2%	2.1%	3.5%	3.2%
Wage & salary income (year-to-year growth)	2.6%	5.4%	6.2%	5.6%	5.4%
Personal savings rate	2.1%	1.8%	(0.4)%	(0.4)%	(0.6)%
Capacity utilization rate	75.7%	78.6%	80.0%	81.7%	82.6%
Housing starts (millions of units)	1.848	1.956	2.068	1.964	1.735
Conventional mortgage rates	5.8%	5.8%	5.9%	6.7%	7.2%
Federal budget surplus (billions of dollars, NIPA basis)	\$(382.7)	\$(406.5)	\$(323.0)	\$(267.3)	\$(289.7)

Many of the factors affecting job growth over the last few years are expected to continue to influence the economy over the forecast period. The primary factors affecting the economy, and presenting risks to the forecast, are: 1) strong productivity growth; 2) inflationary pressures; 3) higher interest rates, weakness in the housing market, and changing credit conditions hampering consumption growth; and 4) weak investment growth.

Figure 1

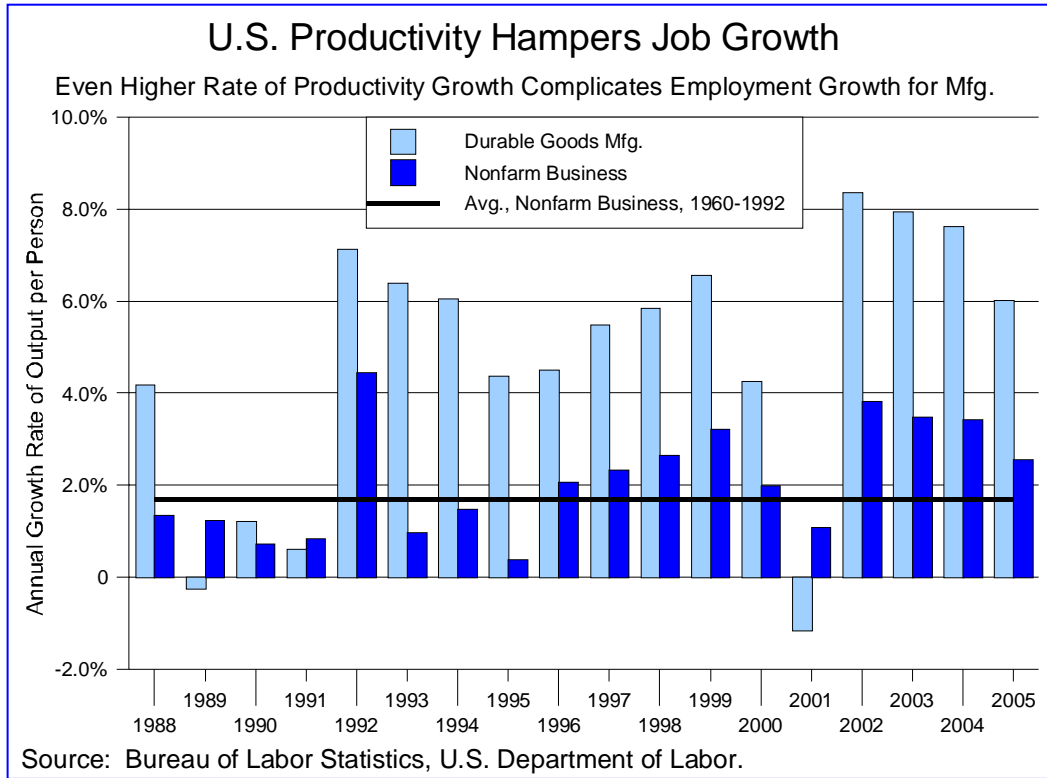


Figure 2

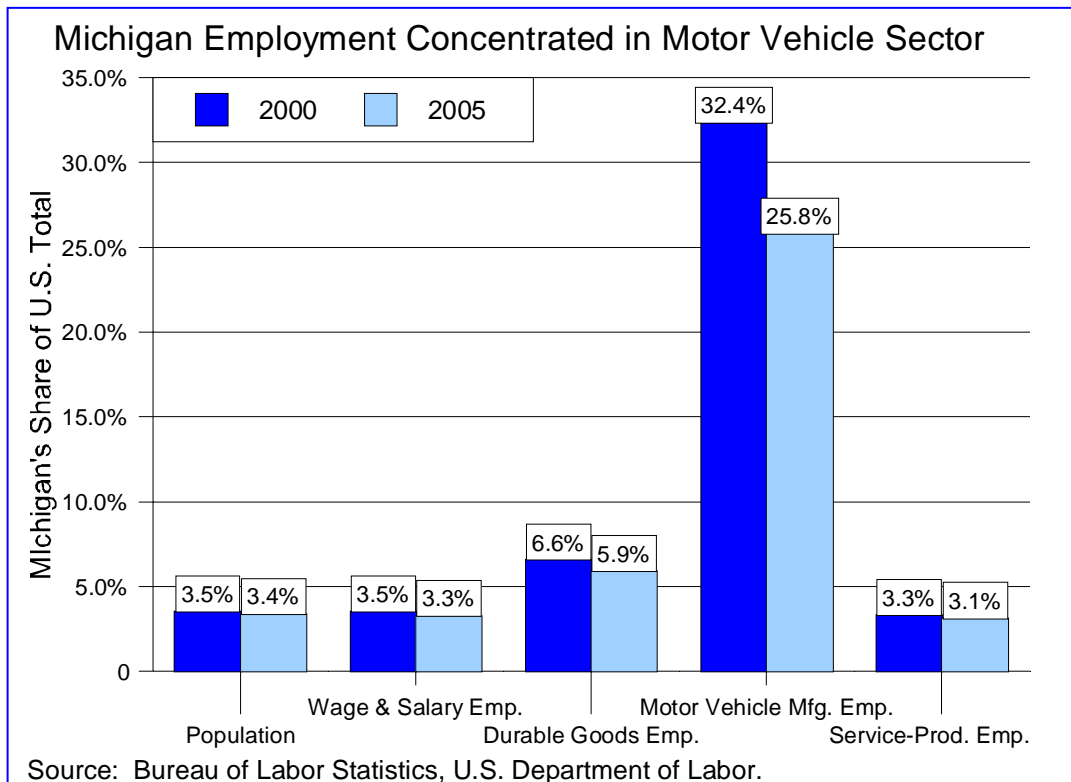
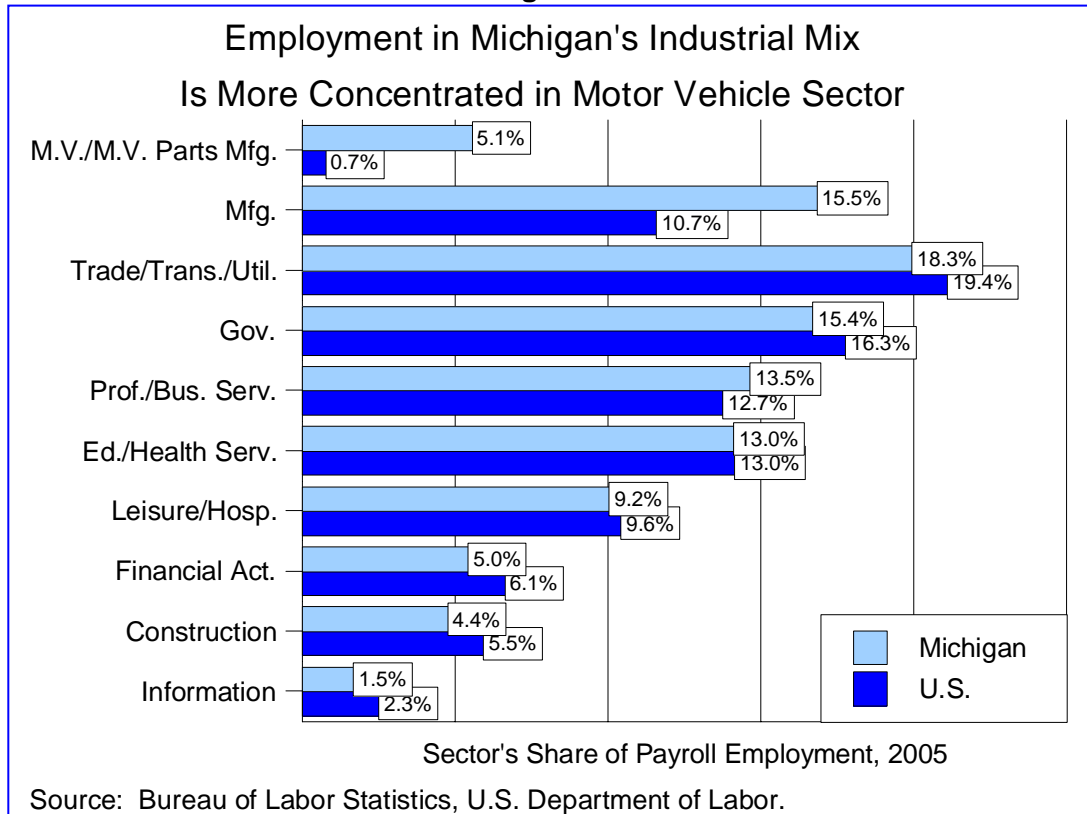


Figure 3



FORECAST SUMMARY

Both the U.S. and Michigan economies are expected to continue growing in 2006 and 2007 ([Figure 4](#)). [Table 1](#) and [Table 2](#) provide a summary of key economic indicators from the SFA's economic forecast, with references to recent years. Inflation-adjusted GDP is projected to grow 3.6% in 2006 and 2.9% in 2007. The modest decline in growth during 2007 reflects slightly slower growth in government spending combined with lower residential investment. The unemployment rate is expected to decline slightly, from 5.1% during 2005 to 4.9% in 2006 before rising to 4.9% in 2007.

In Michigan, both job growth and personal income growth are expected to remain below the national average and the historical state average ([Figures 4](#) and [5](#)). Furthermore, the sectors expected to exhibit the largest gains in employment generally pay wages below those in the sectors with the slowest growth ([Figures 6](#) and [7](#)). Inflation-adjusted personal income is projected to rise 0.9% in 2006 and 1.7% in 2007. On an annual basis, wage and salary employment is forecasted to fall 0.9% in 2006 and 0.4% in 2007, extending the decline in employment to seven consecutive years. These declines will largely reflect continued high productivity and competitive pressures, particularly in the manufacturing sector. Light vehicle sales are expected to decline slightly, from 16.9 million units in 2005 to 16.7 million units in 2006. Light vehicle sales are expected to rise minimally in 2007, to 16.8 million units. Flat sales, combined with productivity improvements and declining market share for domestic vehicle manufacturers, will depress employment and labor force participation. As a result, the unemployment rate will increase from 6.7% in 2005 to 6.8% in 2006 and fall only slightly in 2007, to 6.9%, keeping the Michigan unemployment rate above the national average.

Figure 4

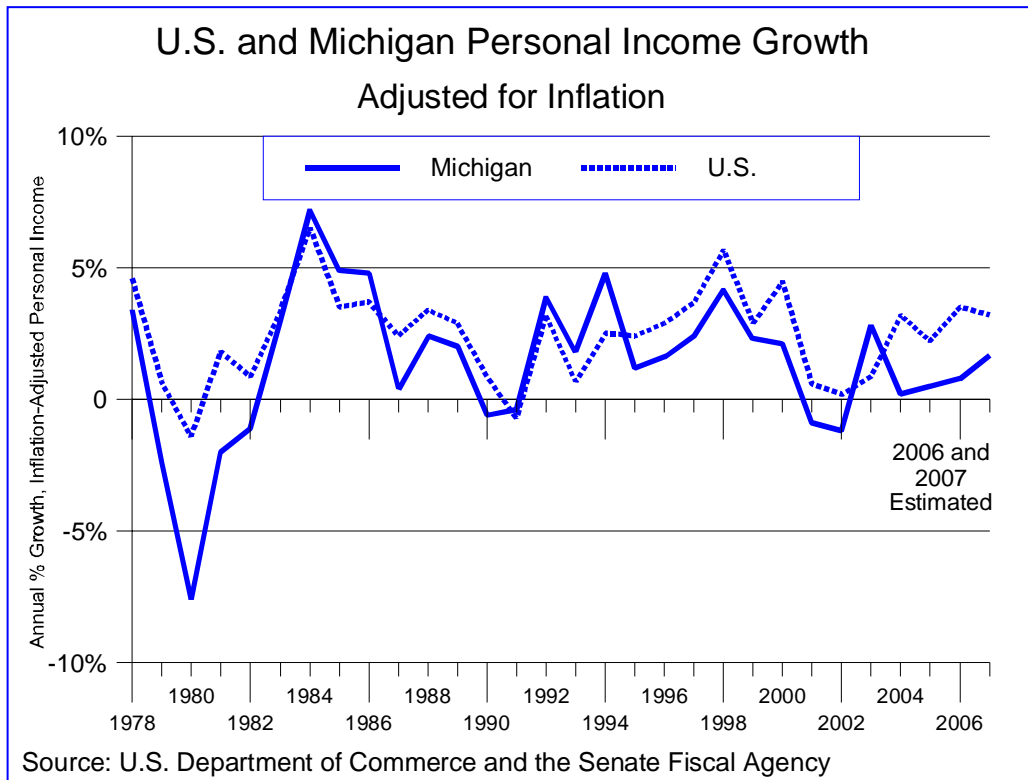


Figure 5

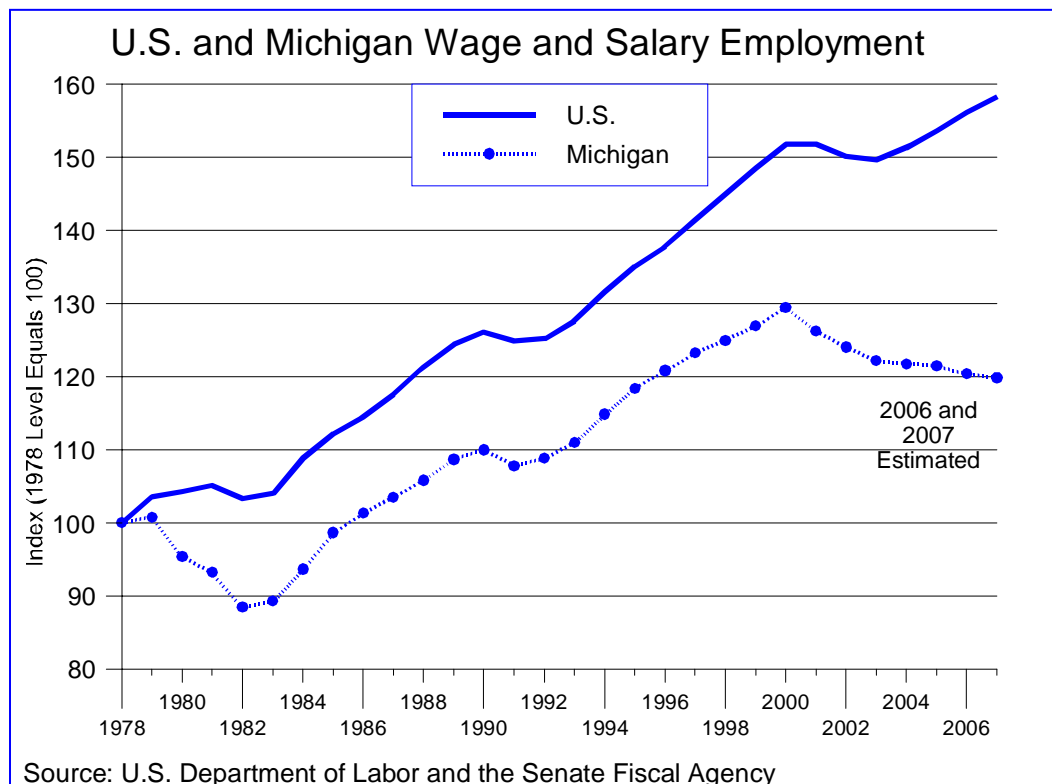


Figure 6

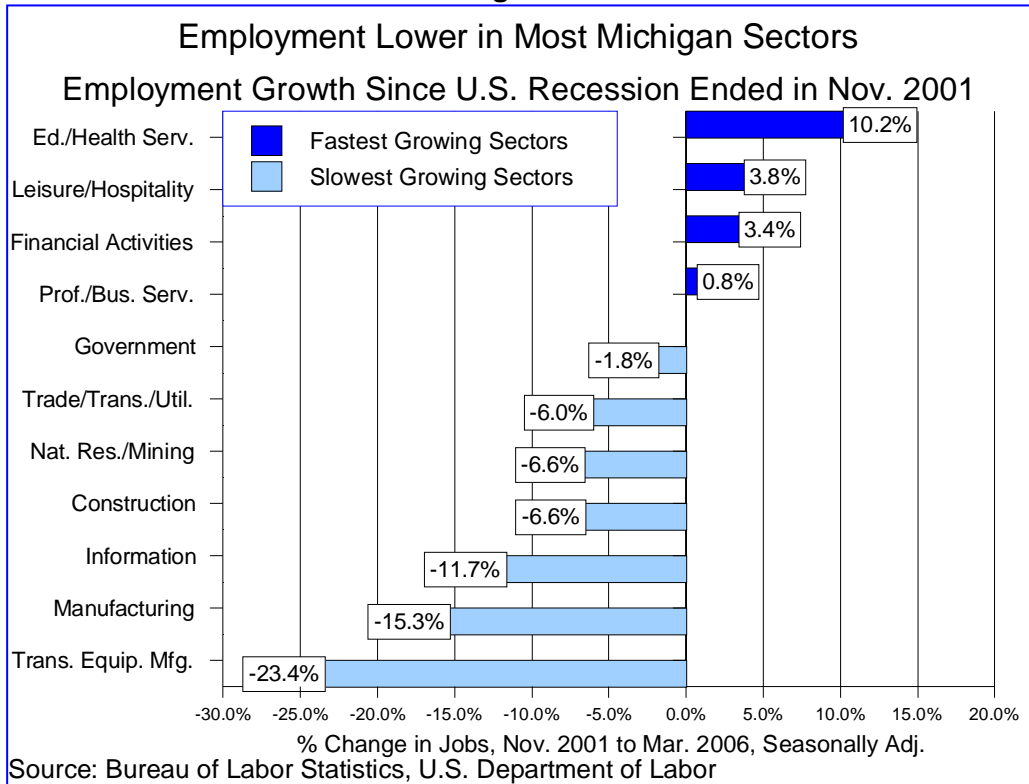
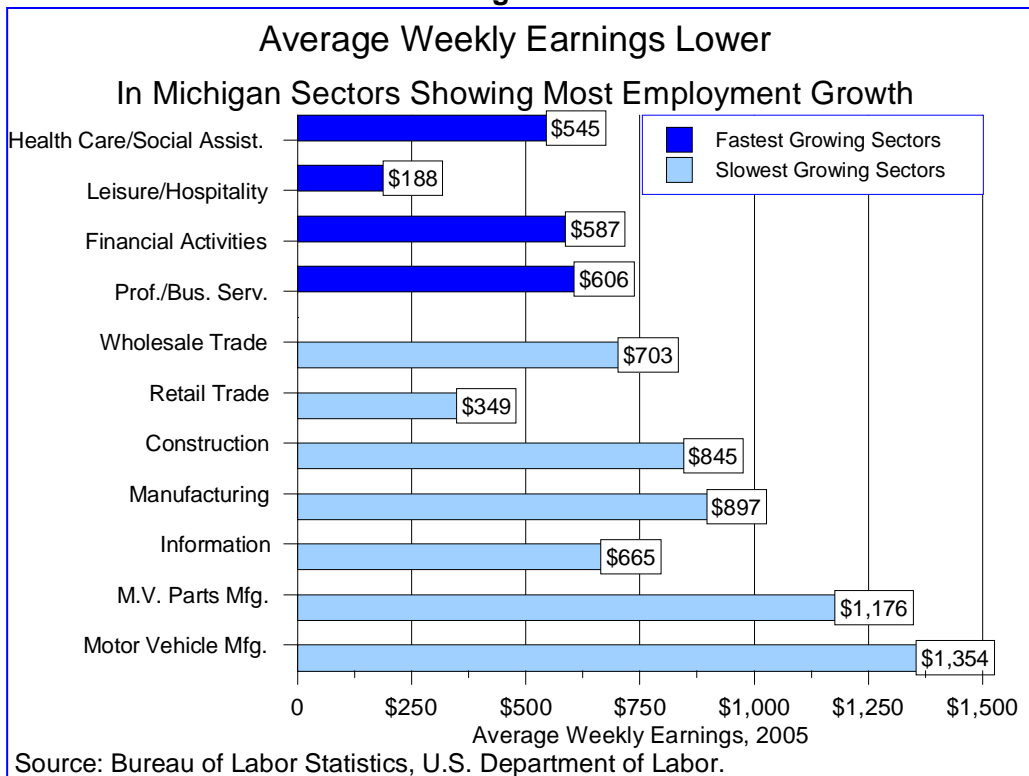


Figure 7



Compared with the January 12, 2006, Consensus Economic Forecast, the U.S. forecast is somewhat stronger in 2006 but mostly unchanged in 2007. The forecast for light vehicles sales remains unchanged. However, most key indicators for Michigan are lower in both 2006 and 2007. Although total wage and salary employment is expected to decrease in most quarters of the forecast, the declines reflect job losses in the manufacturing sector that will more than offset either stable employment levels or meager employment gains in other sectors of the State economy. Michigan income measures also are expected to grow at a slower rate than forecasted in January. Consumer prices in 2006 are expected to rise more rapidly than was predicted in January, largely as a result of national pressures and higher energy prices.

FORECAST ASSUMPTIONS AND RISKS

Forecasting the behavior of the economy requires making assumptions about the behavior of certain key economic variables. The current SFA forecast for 2006 and 2007 is based upon the following assumptions:

Monetary Policy. The Federal funds rate target is currently 5.00%, up 400 basis points from May 2004. The forecast assumes that inflationary concerns are present (discussed on the assumptions for inflation) and the Federal Reserve Board will act on those concerns. Furthermore, as the economy continues growing and Federal deficits remain high, competition for capital will increase. As a result, interest rates are anticipated to continue rising consistently through mid-2007, although at a somewhat slower rate than during the last 18 months, with the Federal funds rate reaching 5.50% at the end of the third quarter of 2006 and 5.75% by mid-2007.

Foreign Economies. Many of the U.S.'s key trading partners' economies are expected to grow more slowly than the U.S. economy during most of the forecast period. After declining only 2.3% during 2006 the dollar is expected to fall in value another 4.6% during 2007. As a result, the forecast predicts the trade deficit will increase slightly in 2006 and remain at roughly 5.7% of GDP over the forecast period.

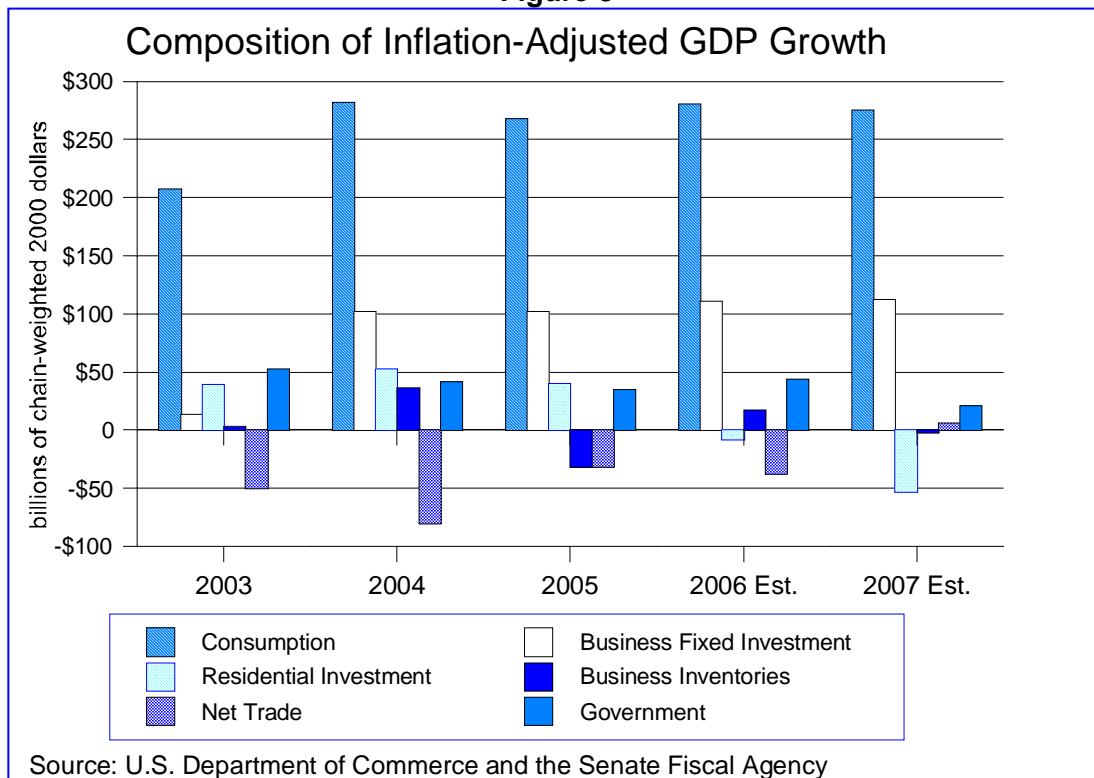
Oil and Energy Prices. The forecast expects oil prices to remain well above even recent historical averages in 2006 and 2007, with the price of west Texas intermediate crude above \$65 per barrel throughout the forecast horizon and averaging more than \$70 per barrel in more than half of the quarters. Other energy prices also are expected to follow a similar pattern over the forecast period. Prices are expected to remain above historical averages for a variety of reasons, ranging from political instability in the Mid-East to limited domestic refining capacity (which is essentially already at maximum) to growing domestic and worldwide energy demands. While higher energy prices will increase incentives to increase drilling and exploration activities, as well making alternative energy sources relatively more attractive, any supply increases from these factors are assumed to be "too little, too late" in that they will have little impact on markets during the forecast horizon.

Risks to the Forecast

All forecasts carry a certain amount of error, but the chances that a forecast will err substantially depend upon certain risks to economic fundamentals upon which the forecast is built. While recent years have offered a fair amount of economic uncertainty, the economic environment in 2006 exhibits even greater uncertainty, which results in the current economic forecast facing a number of risks, most suggesting that in inflation-adjusted terms, the economy could be weaker than forecasted.

Monetary and Fiscal Stimulus. The forecast assumes that the Federal Reserve Open Market Committee will fairly steadily increase rates over the forecast period in an effort to return rates to levels consistent with historical averages and the underlying productivity in the economy, and that a proactive approach will be taken toward any inflationary pressures, which are expected to be significant (as discussed later in this section). The forecast assumes that much of the stimulus effect of fiscal policy has been exhausted and any growth in Federal spending will be restrained, particularly compared with historical levels (Figure 8). Government is expected to add only approximately 0.4 percentage point to economic growth in 2006 and only 0.2 percentage point in 2007. However, there is a significant risk that Federal spending will be higher than forecasted, which would increase economic growth above the forecasted level but also likely result in interest rates being higher than forecasted as well. Such events could weaken both investment, particularly among firms that have borrowed heavily under variable rates, and export growth. Conversely, inflationary pressures could be lower than expected, resulting in lower interest rates and generally higher rates of consumption, investment, and export growth.

Figure 8



Consumer Behavior. Consumption growth remained moderate throughout the slowdown over the last four years, largely through increased borrowing and housing refinance activity. As a result, little, if any, pent-up demand exists in the consumer sector. While the economy is expected to improve, much of the growth in GDP will reflect productivity improvements and improving investment rather than substantial employment gains or stronger consumption growth. As a result, higher interest rates are likely to worsen the burden of servicing consumer debt. The burden of servicing consumer debt reached an all-time high in the third quarter of 2005 and it remained at that level in the fourth quarter. (First quarter 2006 data are not yet available, although first quarter saving rate data suggest the debt burden has not shown any improvement and may have worsened.) In addition, a significant portion of debt at this point is variable-rate debt--meaning that the burden will increase if interest rates rise faster than incomes. When combined with slow job growth, high energy prices, a declining value of the dollar, and modest personal income growth,

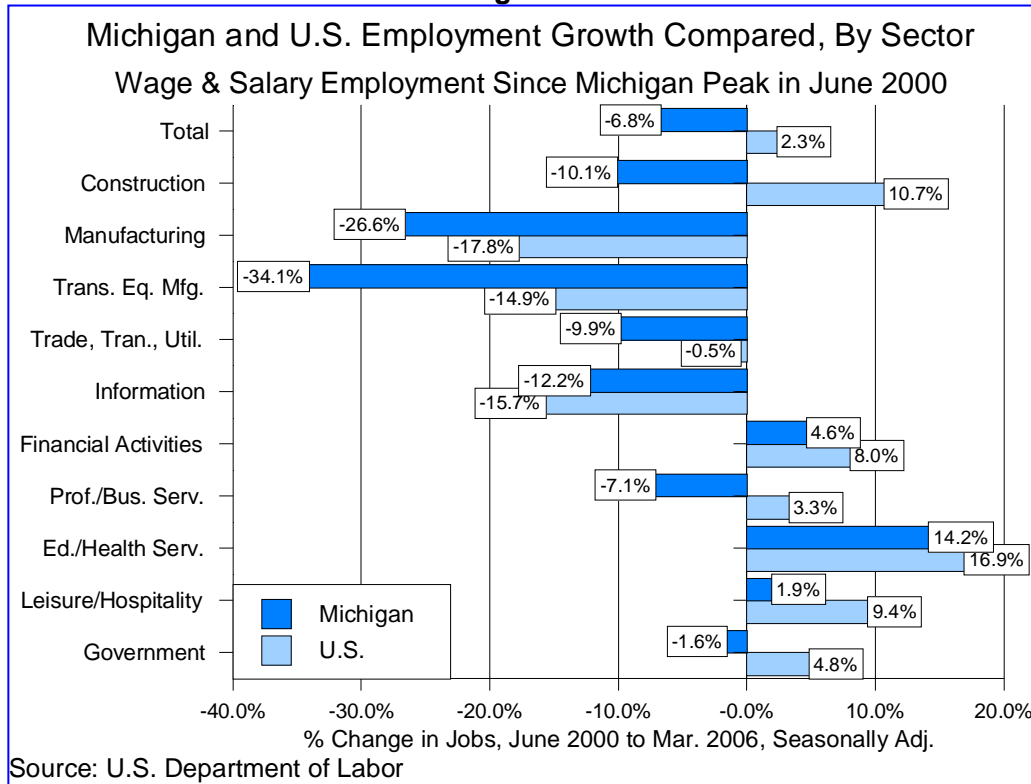
consumption growth is not likely to rise significantly over the forecast period. Financial markets and housing prices are likely to provide significant incentives for consumers to increase the personal saving rate from its current negative levels, although the rate will remain near record lows if predicted consumption levels are generally correct. If the saving rate improves more than expected and/or higher interest rates have a greater effect than forecasted, both consumption growth and economic growth will be lower. Similarly, if the weak employment situation causes consumers to lose confidence in the economy, consumer spending (and thus economic growth) may be lower than expected.

Inflation. While the forecast expects a noticeable increase in the rate of inflation compared with recent years, the expected inflation rates are at or below the rates experienced during the 1990s and are below virtually every year during the 1980s. However, the dollar's value is expected to decline, increasing the price of imports and allowing domestic producers greater pricing power. Several surveys have indicated that producers feel more optimistic about being about to pass on price increases, particularly those attributable to high energy prices. Producers also are likely to face wage pressures that will be compounded by the fact that productivity, while still exhibiting historically strong growth, is growing more slowly than in recent years. Furthermore, continued economic growth also will put substantial demands for additional energy in virtually every sector of the economy. With the petroleum refining sector operating at nearly 100% of capacity even during the slowdown, global energy demand rising and oil production somewhat strained in the near future, energy prices may be substantially greater than forecasted even without external shocks.

Inflation is largely held down in the forecast by reasonably healthy growth in productivity, which may not be as strong as forecasted, minimal wage growth or tightness in the labor market, which may be stronger than predicted, and moderated declines in the value of the dollar, which may fall in value more rapidly than expected. These factors may combine to produce substantial inflationary pressures. Significant inflation could be particularly problematic for the economy, not only resulting in more rapid and larger interest rate increases from the Federal Reserve but also creating significant difficulties for the financial sectors that invested heavily in the refinancing boom of the last few years. These financial sectors are largely dependent upon interest payments locked in at low rates and inflation will result in those loans being repaid with substantially devalued dollars. Furthermore, to the extent that the emphasis is on short-term inflation, the pattern seen in the forecast, where short-term interest rates rise much more rapidly than long-term rates, could be exacerbated and not only squeeze profit margins for banks and other financial intermediaries but also substantially reduce the willingness of lenders to lend. Should that happen, both consumption and investment could grow much more slowly than forecast, or even decline, given that borrowing has generally been fueling consumption gains in recent years and remains a significant source of funds for business investment. Such interest rate patterns, where short-term rates exceed long-term rates, appeared during December 2005 and continued through February 2006, and are often viewed as a precursor to a recession.

Michigan's Dilemma. While over the last five years Michigan's employment situation has fared worse than the national average and, in some cases or time periods within that range, worse than any other state ([Figure 9](#)), Michigan's performance is not particularly inconsistent with other states when this State's economic composition is considered. Generally, states with higher manufacturing concentrations (particularly those in the transportation equipment manufacturing sector) have experienced weaker job performance over the last five years, both because of the economic changes occurring in that sector and the dependence of other sectors within those states on manufacturing activity. As indicated earlier, productivity gains have made American manufacturing firms more profitable and more competitive, but have reduced the need for hiring additional employees to meet increased demand.

Figure 9



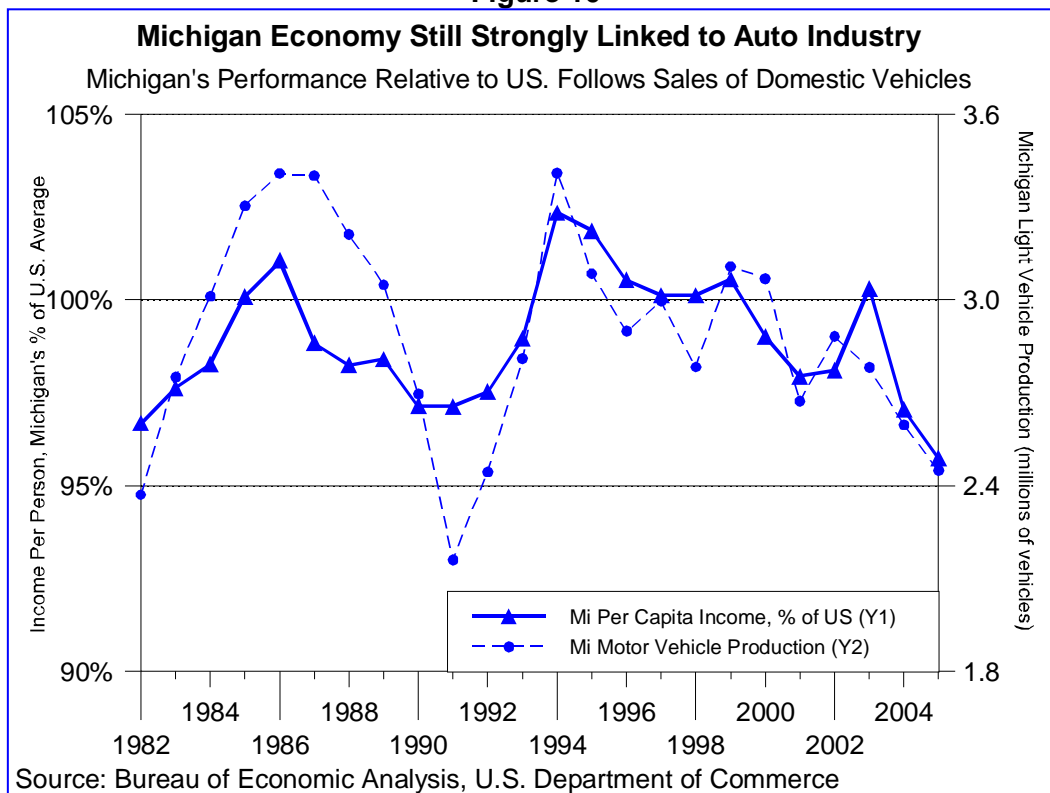
Rising interest rates, a near-zero saving rate, inflationary pressures, and substantial debt burdens are expected to exert a dragging force on any increases in demand over the forecast period. Vehicle sales are expected to remain fairly flat, reflecting the lack of pent-up demand that usually occurs during recessions, while the domestic share of the sales mix is expected to decline. Michigan's economic fortunes have historically been very closely linked with sales of domestically produced light vehicles ([Figure 10](#)), so it is unclear whether Michigan's employment situation would be much better even if productivity were not rising so rapidly in the motor vehicle sector. However, the combination of high productivity and declining market share has been particularly dramatic: on a seasonally adjusted basis, as of March 2006, Michigan had lost more than one out of every three jobs (a decline of more than 119,100 jobs) in transportation equipment manufacturing that existed during the peak in June 2000.

Complicating the economic landscape, much of the downsizing in the domestic transportation equipment manufacturing sector actually has led auto companies to close facilities in other states more often than in Michigan. While those states were already less reliant on transportation equipment manufacturing, the changes mean that they have become even less reliant. However, this "retreat-to-the-core" strategy means that Michigan's economy has become less reliant on transportation equipment manufacturing at a slower rate than the rest of the country. As a result, while that strategy has preserved more transportation equipment manufacturing jobs in Michigan than might otherwise have occurred, it means that the Michigan economy is likely to remain far more vulnerable to swings in the domestic vehicle manufacturing industry than other states.

Because of the number of individuals employed in transportation equipment manufacturing and the likelihood of continued substantial gains in productivity in the vehicle sector, it is likely that absent any shocks, the Michigan economy will spend years adjusting to the change. Offsetting a 10% annual decline in employment in the transportation equipment manufacturing sector essentially requires nearly 0.7% annual employment growth in the rest of the Michigan economy. Between

1995 and 2000, overall employment in Michigan grew only an average of 1.8% per year (while transportation equipment manufacturing employment over that period increased an average of 1.4% per year). For overall employment in Michigan to rise 1.8%, despite a 10% decline in transportation equipment manufacturing employment, employment in the rest of the Michigan economy would need rise by more than 2.5%, which has occurred only in three years since 1986 (and only in six of the last 25 years). Given that productivity improvements, changes in market share, and changing demographics are likely to result in transportation equipment manufacturing employment declining around 5% a year over a number of future years, if employment in other sectors grows at the 1990-2004 average of 0.9% per year, Michigan will not reach the 2000 level of employment again until the year 2016.

Figure 10



The dilemma for Michigan is that for the economy to improve, employment gains need to occur. However, given Michigan's reliance on the automobile industry and manufacturing and the forecast for demand, employment gains are likely to occur only if productivity growth declines. On the other hand, lower productivity growth will impede the ability of Michigan businesses to compete and to be profitable. Thus, Michigan is put in the dilemma that if productivity improves, there will be very little pressure to create additional jobs, although Michigan businesses will be better able to thrive; while if productivity growth falls, there will be a short-term improvement in employment that is likely to be lost as Michigan businesses find it more difficult to compete in the market with firms that are enjoying productivity improvements. The current forecast essentially assumes the State's economy successfully balances these extremes, although it will lean more to the high-productivity/low employment growth end, generating minimal employment gains and maintaining modest profits and competitiveness.

THE FORECAST FOR STATE REVENUE

SENATE FISCAL AGENCY REVENUE ESTIMATES

This section of the Budget Status Report presents the Senate Fiscal Agency's (SFA's) revised estimates for General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue for FY 2005-06 and FY 2006-07. The revenue estimates for each of these fiscal years include the estimates for baseline revenue, which measures what the revenue would be without any changes in the State's tax structure from the previous fiscal year, and net revenue, which presents the revenue estimates including the impact of all enacted tax changes.

REVENUE OVERVIEW

In FY 2005-06, GF/GP and SAF revenue will increase an estimated 1.3% to \$19.46 billion. This rate of growth is slower than the 2.9% increase experienced in FY 2004-05, but is still stronger than was experienced in any year from FY 2000-01 through FY 2003-04. Compared with the January consensus revenue estimate, the revised estimate is up \$19.7 million. The key reasons that the rate of growth will slow in FY 2005-06 include: 1) One-time increases in various revenue sources in FY 2004-05 will not be repeated in FY 2005-06; 2) employment in Michigan will continue to edge downward; 3) real economic growth, as measured by the inflation-adjusted change in Michigan personal income, will slow down, and 4) the new tax cuts for manufacturing businesses will begin reducing single business tax collections during the last part of FY 2005-06.

In FY 2006-07, GF/GP and SAF revenue will total an estimated \$19.98 billion, which represents a 2.7% increase from the revised estimate for FY 2005-06. This revised estimate is up \$7.1 million compared with the January consensus revenue estimate. The revenue estimates are summarized in [Table 3](#).

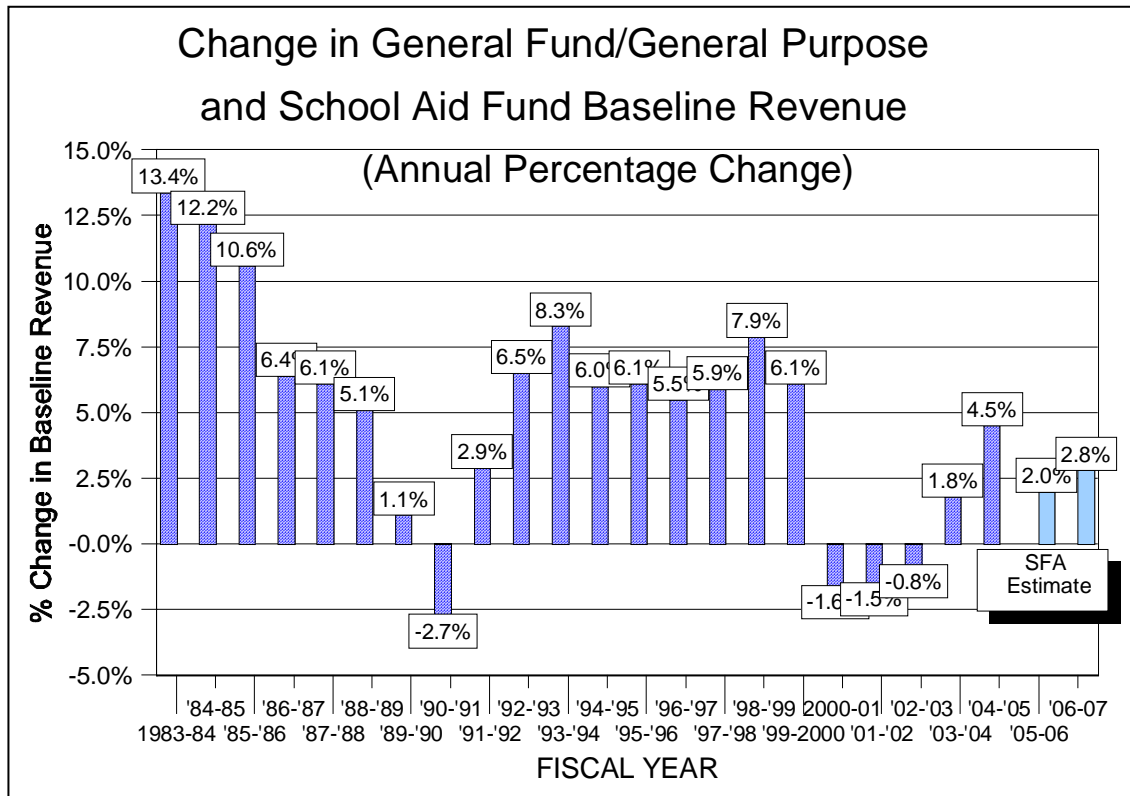
Historical Perspective

[Figure 11](#) presents a historical overview of the percentage change in baseline GF/GP and SAF revenue since FY 1982-83. After experiencing very steady and relatively strong growth from FY 1992-93 to FY 1999-2000, baseline GF/GP and SAF revenue declined for three consecutive years from FY 2000-01 to FY 2002-03. Positive baseline growth was renewed in FY 2003-04 and FY 2004-05, but at more modest levels than experienced in the 1990s. In FY 2005-06, baseline GF/GP and SAF revenue is expected to increase 2.0% and then increase by 2.8% in FY 2006-07. While the projected growth rates for baseline GF/GP and SAF revenue for FY 2005-06 and FY 2006-07 reflect an improvement from the declines in revenue experienced for three consecutive years beginning in FY 2000-01, these projected growth rates are still much lower than the growth rate experience most years during the past two decades.

Table 3

SENATE FISCAL AGENCY REVENUE ESTIMATES FOR FY 2005-06 AND FY 2006-07 GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND (Millions of Dollars)			
	FY 2004-05 Final	FY 2005-06 Revised Est.	FY 2006-07 Revised Est.
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	\$8,163.3	\$8,290.0	\$8,488.3
Tax Changes Not In Baseline	135.5	(28.8)	(59.8)
Revenue After Tax Changes:			
Net Income Tax	4,121.1	4,202.8	4,295.7
Single Business Tax & Insurance Tax	2,163.0	2,072.9	2,114.3
Other Taxes	1,597.0	1,631.4	1,613.2
Total Taxes	7,881.1	7,907.1	8,023.3
Non-Tax Revenue	417.7	354.1	360.2
TOTAL GF/GP REVENUE	\$8,298.9	\$8,261.2	\$8,428.4
SCHOOL AID FUND			
Baseline SAF	\$10,914.6	\$11,172.1	\$11,524.1
Tax Changes Not In Baseline	(5.0)	25.2	22.8
TOTAL SAF REVENUE	\$10,909.7	\$11,197.3	\$11,546.9
BASELINE GF/GP AND SAF REVENUE	19,078.0	19,462.1	20,012.4
Tax & Revenue Changes	130.5	(3.6)	(37.0)
GF/GP & SAF REV. AFTER CHANGES	\$19,208.5	\$19,458.5	\$19,975.4
<u>ADDENDUM:</u>			
Sales Tax	\$6,599.1	\$6,696.6	\$6,943.7
PERCENT CHANGE			
GENERAL FUND/GENERAL PURPOSE			
Baseline Revenue	5.5%	1.6%	2.4%
Revenue After Tax Changes:			
Net Income Tax	3.6	2.0	2.2
Single Business Tax & Insurance Tax	4.7	(4.2)	2.0
Other Taxes	1.7	2.2	(1.1)
Total Taxes	3.6%	0.3%	1.5%
Nontax Revenue	(4.3)	(15.2)	1.7
TOTAL GF/GP REVENUE	3.2%	(0.5)%	2.0%
SCHOOL AID FUND			
Baseline SAF	3.7%	2.4%	3.2%
TOTAL SAF REVENUE	2.8%	2.6%	3.1%
BASELINE GF/GP AND SAF REVENUE	4.5%	2.0%	2.8%
GF/GP & SAF REV. AFTER CHANGES	3.0%	1.3%	2.7%
<u>ADDENDUM:</u>			
Sales Tax	1.9%	1.5%	3.7%

Figure 11



REVISED REVENUE ESTIMATES FOR FY 2005-06

General Fund/General Purpose and SAF revenue is expected to total \$19.46 billion in FY 2005-06, which is up 1.3%, or \$250.0 million, from FY 2004-05. Compared with the January 2006 consensus estimate, this revised estimate is up \$19.7 million. The revised GF/GP and SAF revenue estimates for FY 2005-06 are presented in Table 4.

General Fund/General Purpose

General Fund/General Purpose revenue will total an estimated \$8.26 billion, which is down 0.5%, or \$37.7 million, from the final level for FY 2004-05. This modest decline is attributable to four major factors: 1) Given the relatively weak level of economic activity forecast for the Michigan economy in 2006, baseline revenue will experience only a modest increase of 1.6%, 2) a large estate tax payment and audit judgment tax payments totaling about \$90.0 million helped boost FY 2004-05 revenue, but will not be repeated in FY 2005-06, 3) the new single business tax reduction designed to provide tax relief to the manufacturing sector will lower single business tax revenue by at least \$103.9 million in FY 2005-06, and 4) the estate tax is now repealed so estate tax collections in FY 2005-06 will reflect late payments only and therefore will be down significantly. Offsetting at least a portion of these negative factors is a change in the earmarking of tobacco tax revenue which will distribute an additional \$110.0 million to GF/GP revenue in FY 2005-06 compared with FY 2004-05. This revised GF/GP revenue estimate is up \$53.4 million from the January 2006 consensus revenue estimate.

Single Business Tax Cut. In December 2005, a business tax relief package was enacted. This legislation, effective January 1, 2006, created 1) a new 15.0% refundable credit for industrial personal property, 2) a new 100% credit for new personal property in Michigan that is used by

industrial or high technology workers who are transferred to Michigan from other states or countries, and 3) increased the weight applied to the sales portion of the apportionment factor from 90.0% to 92.5% on January 1, 2006, and 95.0% on January 1, 2008. While these changes will have revenue implications through FY 2009-10, they will reduce single business tax revenue an estimated \$103.9 million in FY 2005-06 and \$114.6 million in FY 2006-07, and because all single business tax revenue goes into the General Fund, the impact of these tax cuts will be on GF/GP revenue.

School Aid Fund

School Aid Fund revenue from earmarked taxes and the lottery is expected to total \$11.20 billion in FY 2005-06, which is up 2.6%, or \$287.6 million, from the FY 2004-05 level. This revised estimate is down \$33.7 million compared with the January consensus revenue estimate. This downward revision is primarily due to slower-than-expected increases in the sales and use taxes, which are being partially offset by higher-than-expected increases in income tax and lottery revenue. The SAF revenue estimate for FY 2005-06 also is summarized in Table 4.

Major Taxes and Lottery

Income Tax. Net income tax collections will total an estimated \$6.27 billion in FY 2005-06. This represents a 2.6%, or \$158.5 million, increase from FY 2004-05, and is up \$96.0 million from the January consensus estimate. The major reason for the upward revision is that both quarterly and annual payments are much stronger than estimated in January, primarily reflecting growth in the stock market. This upward revision benefits both GF/GP and SAF revenue. While most of the income tax revenue goes to the General Fund, the SAF receives approximately 26.0% of gross income tax collections.

Sales Tax. So far in FY 2005-06, sales tax collections are lagging well behind the January consensus estimate. Fiscal year-to-date sales tax collections are unchanged from year-ago collections, while the January consensus estimate was that sales tax collections would increase 3.0%. A major reason for this shortfall is that sales tax collections from motor vehicle transactions are down 12.7% so far in FY 2005-06. This marks the fourth consecutive year that motor vehicle sales tax collections have fallen significantly below year-ago levels. The decline from FY 2001-02 through FY 2004-05 was a sharp 25.4%, and is attributable to a decline in the number of vehicles sold. If vehicle sales had followed a more normal historical trend over the past four years, sales tax collections from motor vehicle sales would be about \$200.0 million higher in FY 2005-06. As a result, the estimate of sales tax revenue has been lowered \$103.2 million to \$6.70 billion, compared with the January consensus estimate. This downward revision in the sales tax estimate primarily affects the SAF, revenue sharing to local governments, and GF/GP revenue.

Single Business Tax. The single business tax revenue estimate has been revised upward \$20.0 million to \$1.84 billion, based on stronger-than-expected collections so far in FY 2005-06.

Lottery Revenue. Net lottery revenue will total an estimated \$711.5 million in FY 2005-06. This revised estimate is up \$26.5 million compared with the January consensus estimate. All net lottery revenue goes to the SAF.

Table 4

**FY 2005-06 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)**

	Change From FY 2004-05				\$ Change from 01/06 Consensus
	FY 2004-05 Final	FY 2005-06 Revised Est.	Dollar Change	Percent Change	
GEN'L FUND/GEN'L PURPOSE					
Baseline Revenue	\$8,163.3	\$8,290.0	\$126.6	1.6%	\$42.8
Tax Changes Not In Baseline	135.5	(28.8)	(164.3)	---	10.6
Revenue After Tax Changes:					
<u>Personal Income Tax</u>					
Gross Collections	7,719.0	7,947.7	228.7	3.0	81.0
Less: Refunds	(1,610.8)	(1,681.0)	(70.2)	4.4	15.0
Net Income Tax Collections	6,108.2	6,266.7	158.5	2.6	96.0
Less: Earmarking to SAF	(1,985.6)	(2,062.4)	(76.8)	3.9	(21.0)
Campaign Fund	(1.5)	(1.5)	0.0	0.0	0.0
Net Income Tax to GF/GP	\$4,121.1	\$4,202.8	\$81.7	2.0%	\$75.0
<u>Other Taxes</u>					
Single Business Tax	1,913.5	1,837.9	(75.6)	(4.0)	20.0
Sales	99.2	99.5	0.3	0.3	(5.8)
Use	934.8	934.4	(0.4)	(0.0)	(27.1)
Cigarette	116.5	234.2	117.7	101.1	3.0
Insurance Company Premiums	249.5	235.0	(14.5)	(5.8)	(20.0)
Telephone & Telegraph	99.1	83.0	(16.1)	(16.2)	0.0
Estate	101.5	0.5	(101.0)	(99.5)	(4.5)
Oil & Gas Severance	66.7	96.0	29.3	43.9	12.0
Casino	42.2	44.1	1.9	4.5	0.9
All Other	137.1	139.7	2.6	1.9	0.0
Subtotal Other Taxes	\$3,760.0	\$3,704.3	\$(55.7)	(1.5)%	\$(21.6)
Total Nontax Revenue	417.7	354.1	(63.6)	(15.2)	0.0
GF/GP REV. AFTER TAX CHANGES	\$8,298.9	\$8,261.2	\$(37.7)	(0.5)%	\$53.4
SCHOOL AID FUND					
Baseline Revenue	\$10,914.6	\$11,172.1	\$257.5	2.4%	\$(33.3)
Tax Changes Not In Baseline	(5.0)	25.2	30.2	(608.3)	(0.4)
Revenue After Tax Changes:					
Sales Tax	4,805.7	4,874.1	68.4	1.4	(75.7)
Lottery Revenue	667.6	711.5	43.9	6.6	26.5
State Education Property Tax	1,914.5	2,010.0	95.5	5.0	0.0
Real Estate Transfer Tax	313.5	320.0	6.5	2.1	10.0
Income Tax	1,985.6	2,062.4	76.8	3.9	21.0
Casino Tax	97.6	102.0	4.4	4.5	2.0
Other Revenue	1,125.1	1,117.2	(7.9)	(0.7)	(17.5)
SAF REVENUE AFTER TAX CHANGES	\$10,909.7	\$11,197.3	\$287.6	2.6%	\$(33.7)
BASELINE GF/GP AND SAF	\$19,078.0	\$19,462.1	\$384.1	2.0%	\$9.5
Tax & Revenue Changes	130.5	(3.6)	(134.1)	(102.8)	10.2
GF/GP & SAF REV. AFTER CHANGES	\$19,208.5	\$19,458.5	\$250.0	1.3%	\$19.7
SALES TAX	\$6,599.1	\$6,696.6	\$97.5	1.5%	\$(103.2)

Note: Baseline revenue in this table is based on FY 2004-05 to provide an accurate comparison of the revenue in these two fiscal years.

FY 2006-07 REVISED REVENUE ESTIMATES

For FY 2006-07, GF/GP and SAF revenue will total an estimated \$19.98 billion. This represents an increase of 2.7%, or \$516.9 million, from the revised estimate for FY 2005-06. This revised estimate for FY 2006-07 is up \$7.1 million from the January 2006 consensus estimate. The major reason for this modest upward revision is that increases in the income tax, single business tax, and lottery revenue estimates are slightly greater than downward revisions to the sales and use tax revenue estimates. This net upward revision in the revenue estimates results in a modest increase in the GF/GP revenue estimate and a slight decrease in the SAF revenue estimate. These revised revenue estimates are summarized in Table 5.

General Fund/General Purpose Revenue

General Fund/General Purpose revenue will total an estimated \$8.43 billion in FY 2006-07, which represents an increase of 2.0%, or \$167.3 million, from the revised estimate for FY 2005-06. Compared with the January 2006 consensus revenue estimate, this revised estimate for GF/GP revenue is up \$51.3 million. This additional revenue is due to upward revisions in the income and single business tax revenue estimates, which more than offset downward revisions in the sales, use, and insurance tax collection estimates. The revised GF/GP revenue estimates are summarized in Table 5.

School Aid Fund

School Aid Fund revenue from all earmarked taxes and the lottery will total an estimated \$11.55 billion in FY 2006-07, which represents a 3.1%, or \$349.7 million, increase from the revised estimate for FY 2005-06. This revised estimate is \$44.2 million below the January 2006 consensus revenue estimate, due to downward revisions in the sales and use tax revenue estimates that are greater than upward revisions in the income tax and lottery revenue estimates. School Aid Fund revenue estimates also are summarized in Table 5.

Major Taxes and Lottery

Income Tax. In FY 2006-07, net income tax revenue will total an estimated \$6.42 billion, which represents an increase of 2.4% or \$153.1 million. This increase will be due primarily to growth in quarterly and annual payments of 4.7% and 5.8%, respectively. In addition, withholding payments, which account for over 80.0% of gross income tax collections, are expected to increase 2.4%. This growth in gross collections will be offset somewhat by an increase in income tax refunds. This expected increase in net income tax revenue will benefit both GF/GP and SAF revenue.

Single Business Tax. Revenue generated by the single business tax will increase an estimated 1.7% in FY 2006-07 to \$1.87 billion. Continued declines in payroll employment, coupled with the impact of the new manufacturing tax credits, will keep these business tax receipts from growing more rapidly. All single business tax revenue goes into the GF/GP budget.

Sales Tax. Sales tax collections are expected to increase 3.7% in FY 2006-07 to \$6.94 billion. This increase is predicated on the estimate that sales tax collections from motor vehicle transactions will finally at least level off. Of the total amount forecast for FY 2006-07, \$5.06 billion will be earmarked to the SAF and \$104.3 million will go to GF/GP revenue. The remaining sales tax revenue will go primarily to revenue sharing and the Comprehensive Transportation Fund. A plan to continue to freeze revenue sharing payments would generate additional sales tax revenue for the GF/GP budget. This is discussed in the final section of this report.

Table 5
FY 2006-07 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(Millions of Dollars)

	Change From FY 2005-06				
	FY 2005-06 Revised Est.	FY 2006-07 Revised Est.	Dollar Change	Percent Change	\$ Change from 01/06 Consensus
GEN'L FUND/GEN'L PURPOSE					
Baseline Revenue	\$8,290.0	\$8,488.3	\$198.3	2.4%	\$52.3
Tax Changes Not In Baseline	(28.8)	(59.8)	(31.0)	107.6	(1.1)
Revenue After Tax Changes:					
<u>Personal Income Tax</u>					
Gross Collections	7,947.7	8,179.8	232.1	2.9	80.9
Less: Refunds	(1,681.0)	(1,760.0)	(79.0)	4.7	15.0
Net Income Tax Collections	6,266.7	6,419.8	153.1	2.4	95.9
Less: Earmarking to SAF	(2,062.4)	(2,122.6)	(60.1)	2.9	(21.0)
Campaign Fund	(1.5)	(1.5)	0.0	0.0	0.0
Net Income Tax to GF/GP	\$4,202.8	\$4,295.7	\$93.0	2.2%	\$74.9
<u>Other Taxes</u>					
Single Business Tax	1,837.9	1,868.3	30.4	1.7	19.9
Sales	99.5	104.3	4.8	4.9	(9.5)
Use	934.4	974.7	40.3	4.3	(27.5)
Cigarette	234.2	229.3	(5.0)	(2.1)	2.0
Insurance Company Premiums	235.0	246.0	11.0	4.7	(20.0)
Telephone & Telegraph	83.0	80.0	(3.0)	(3.6)	0.0
Estate	0.5	0.0	(0.5)	(100.0)	0.0
Oil & Gas Severance	96.0	78.0	(18.0)	(18.8)	10.0
Casino	44.1		(44.1)	(100.0)	
All Other	139.7	146.9	7.2	5.2	0.0
Subtotal Other Taxes	\$3,704.3	\$3,727.5	\$23.2	0.6%	\$(25.2)
Total Nontax Revenue	354.1	360.2	6.1	1.7	0.0
GF/GP REV. AFTER TAX CHANGES	\$8,261.2	\$8,428.4	\$167.3	2.0%	\$51.3
SCHOOL AID FUND					
Baseline Revenue	\$11,172.1	\$11,524.1	\$352.0	3.2%	\$(43.4)
Tax Changes Not In Baseline	25.2	22.8	(2.4)	(9.5)	(0.7)
Revenue After Tax Changes:					
Sales Tax	4,874.1	5,056.5	182.4	3.7	(77.3)
Lottery Revenue	711.5	713.0	1.5	0.2	23.0
State Education Property Tax	2,010.0	2,108.0	98.0	4.9	0.0
Real Estate Transfer Tax	320.0	311.0	(9.0)	(2.8)	3.0
Income Tax	2,062.4	2,122.6	60.1	2.9	21.0
Casino Tax	102.0	104.1	2.1	2.0	3.7
Other Revenue	1,117.2	1,131.8	14.6	1.3	(17.6)
SAF REVENUE AFTER TAX CHANGES	\$11,197.3	\$11,546.9	\$349.7	3.1%	\$(44.2)
BASELINE GF/GP AND SAF	\$19,462.1	\$20,012.4	\$550.3	2.8%	\$8.9
Tax & Revenue Changes	(3.6)	(37.0)	(33.4)	----	(1.8)
GF/GP & SAF REV. AFTER CHANGES	\$19,458.5	\$19,975.4	\$516.9	2.7%	\$7.1
SALES TAX	6,696.6	6,943.7	247.1	3.7	(105.4)

Note: Baseline revenue in this table is based on FY 2004-05 to provide an accurate comparison of the revenue in these two fiscal years.

State Education Property Tax. The State education property tax is expected to generate \$2.11 billion in FY 2006-07, representing an increase of 4.9%. All of this revenue will go the SAF.

Lottery. Net lottery revenue will total an estimated \$713.0 million in FY 2006-07, which is up 0.2% from the revised level for FY 2005-06. All net earnings from the lottery go into the SAF.

SENATE FISCAL AGENCY BASELINE REVENUE FORECAST HISTORY

The history of the Senate Fiscal Agency's and consensus estimates for GF/GP and SAF baseline revenue for FY 2005-06 and FY 2006-07 is presented in Tables 6 and 7. Baseline estimates are used to track the forecast history for these two fiscal years in order to avoid the wide swings in revenue estimates that occur when tax changes are enacted. In addition, in order to provide an accurate comparison, all of the previous baseline estimates made for FY 2004-05 and FY 2005-06 have been adjusted to reflect a consistent baseline based on the FY 2004-05 tax structure.

For FY 2005-06, the initial GF/GP and SAF baseline revenue estimate was made in January 2005 at \$19.42 billion, as shown in Table 6. It was lowered slightly in May 2005 to \$19.38 billion and then was increased to \$19.46 billion in August 2005. In January 2006, there was essentially no change in the estimate. Based on the SFA's revised estimates presented in this report, GF/GP and SAF baseline revenue for FY 2005-06 is estimated at \$19.46 billion. This revised estimate is up only \$9.5 million, which registers as a zero percent change from the January consensus estimate. Compared with the initial estimate made in January 2005, this revised estimate is up \$43.3 million, or 0.2%.

Table 6

CHANGES IN SENATE FISCAL AGENCY BASELINE REVENUE ESTIMATES FOR FY 2005-06 (Millions of Dollars)			
Forecast Date	GF/GP	SAF	Total
January 7, 2005	\$8,151.8	\$11,267.0	\$19,418.8
January 13, 2005 ^{a)}	8,159.1	11,279.6	19,438.7
May 16, 2005	8,060.7	11,198.1	19,258.8
May 19, 2005 ^{a)}	8,152.9	11,231.7	19,384.6
August 17, 2005	8,234.2	11,225.8	19,460.0
August 17, 2005 ^{a)}	8,233.7	11,227.2	19,460.9
January 11, 2006	8,270.3	11,224.8	19,495.1
January 12, 2006 ^{a)}	8,247.2	11,205.4	19,452.6
May 15, 2006	8,290.0	11,172.1	19,462.1
<u>Change From Previous Estimate:</u>			
Dollar Change	\$42.8	\$(33.3)	\$9.5
Percent Change	0.5%	(0.3)%	0.0%
<u>Change From Initial Estimate:</u>			
Dollar Change	\$138.2	\$(94.9)	\$43.3
Percent Change	1.7%	(0.8)%	0.2%
a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			
Note: Baseline base year equals FY 2004-05.			

The initial GF/GP and SAF baseline revenue estimate for FY 2006-07 was made in January 2006 at \$19.92 billion, as shown in Table 7. This estimate was increased to \$20.00 billion at the January 2006 Consensus Revenue Estimating Conference. Based on the SFA's revised revenue estimates presented in this report, GF/GP and SAF baseline revenue for FY 2006-07 is estimated at \$20.01 billion, representing a slight \$8.9 million increase from the January estimate. Compared with the SFA's initial estimate made in January 2006, this revised estimate is up \$93.5 million or 0.5%.

Table 7
CHANGES IN SENATE FISCAL AGENCY
BASELINE REVENUE ESTIMATES FOR FY 2006-07
(Millions of Dollars)

Forecast Date	GF/GP	SAF	Total
January 11, 2006	\$8,376.2	\$11,542.7	\$19,918.9
January 12, 2006 ^{a)}	8,436.0	11,567.5	20,003.5
May 15, 2006	8,488.3	11,524.1	20,012.4
<u>Change From Previous Estimate:</u>			
Dollar Change	\$52.3	\$(43.4)	\$8.9
Percent Change	0.6%	(0.4)%	0.0%
<u>Change From Initial Estimate:</u>			
Dollar Change	\$112.1	\$(18.6)	\$93.5
Percent Change	1.3%	(0.2)%	0.5%
a) Consensus estimate between the Senate Fiscal Agency, House Fiscal Agency, and Department of Treasury.			
Note: Baseline base year equals FY 2003-04.			

BUDGET STABILIZATION FUND

The Counter-Cyclical Budget and Economic Stabilization Fund (BSF) was established by Public Act (P.A.) 76 of 1977. The BSF is a cash reserve to which the State, in years of economic growth, adds revenue, and from which, in years of economic recession, the State withdraws revenue. The Fund's purposes are to mitigate the adverse effects on the State budget of downturns in the business cycle and to reserve funds that can be available during periods of high unemployment for State projects that will increase job opportunities.

The requirements for contributions to and withdrawals from the BSF are established in State law. By statute, revenue may be added to the BSF when Michigan personal income, less transfer payments and adjusted for inflation, increases by more than 2.0%. When the growth in real personal income less transfer payments is over 2.0%, the pay-in to the BSF is equal to the percentage growth in excess of 2.0% multiplied by the total General Fund/General Purpose (GF/GP) revenue.

Funds may be transferred out of the BSF for budget stabilization purposes when Michigan personal income less transfer payments, adjusted for inflation, decreases on a calendar-year basis. The withdrawal equals the percentage decline in adjusted real personal income multiplied by the annual GF/GP revenue. Thus, funds contributed to the BSF in growth years are used to supplement current revenue during a recession, reducing the need either to increase taxes or to reduce State services in a time of poor economic conditions.

Withdrawals from the BSF also are permitted for State job creation programs in times of high unemployment. When the State's unemployment rate averages between 8.0% and 11.9% during a calendar quarter, 2.5% of the balance in the BSF may be withdrawn during the subsequent quarter and appropriated for projects that will create job opportunities. If the unemployment rate averages 12% or higher for a calendar quarter, up to 5.0% of the BSF balance may be withdrawn.

In order for any payment into or out of the BSF actually to occur under either the personal income or the unemployment rate formula described above, the payment must be appropriated by the Legislature. In addition, the Legislature may appropriate transfers into or out of the BSF even if the formulas do not trigger a transfer. For example, in FY 1998-99, the Legislature appropriated a transfer into the BSF of \$55.2 million in response to the personal income formula; however, the Legislature also appropriated to the BSF the ending balance of the General Fund/General Purpose budget, which equaled \$189.2 million. Also in FY 1998-99, the Legislature appropriated the transfer of \$73.7 million from the BSF to the School Aid Fund to finance scheduled payments to K-12 school districts required under the *Durant* court case.

Table 8 presents the recent history of the BSF in terms of transfers into and out of the Fund, interest earnings, and year-end balances. Also presented in this table are the estimates for FY 2005-06 and FY 2006-07. The BSF year-end balance as a percentage of GF/GP and SAF revenue is shown in Figure 12, and the estimated economic stabilization trigger calculations for FY 2005-06 and FY 2006-07 are presented in Table 9.

FY 2004-05

In FY 2004-05, the BSF had a beginning balance of \$81.3 million and during the year \$2.0 million in interest was earned. To help balance the FY 2004-05 budget, \$81.3 million was appropriated from the BSF to the General Fund, leaving only a \$2.0 million balance in the Fund at the end of the fiscal year.

FY 2005-06

Based on the SFA's revised estimates for personal income, transfer payments, and the Detroit Consumer Price Index (CPI), the budget stabilization formula triggers a payment out of the Fund equal to \$12.9 million, as shown in Table 9. While any transfers into or out of the Fund must be appropriated for them actually to occur, this transfer out of the Fund will not occur because the Fund balance will equal only an estimated \$2.1 million by the end of FY 2005-06.

FY 2006-07

In FY 2006-07, real personal income less transfer payments is expected to increase, but by less than 2.0%, so no transfer into or out of the Fund will be triggered. With interest earnings, the balance in the BSF will total an estimated \$2.2 million by the end of FY 2006-07.

Table 8
BUDGET AND ECONOMIC STABILIZATION FUND
TRANSFERS, EARNINGS AND FUND BALANCE
FY 1998-99 TO FY 2006-07 ESTIMATE
(Millions of Dollars)

Fiscal Year	Pay-In	Interest Earned	Pay-Out	Fund Balance
1998-99	\$244.4	\$51.2	\$73.7	\$1,222.5
1999-00	100.0	73.9	132.0	1,264.4
2000-01	0.0	66.7	337.0	994.1
2001-02	0.0	20.8	869.8	145.2
2002-03	0.0	1.8	147.0	0.0
2003-04	81.3	0.0	0.0	81.3
2004-05	0.0	2.0	81.3	2.0
Senate Fiscal Agency estimates:				
2005-06	0.0	0.1	0.0	2.1
2006-07	0.0	0.1	0.0	2.2

Figure 12

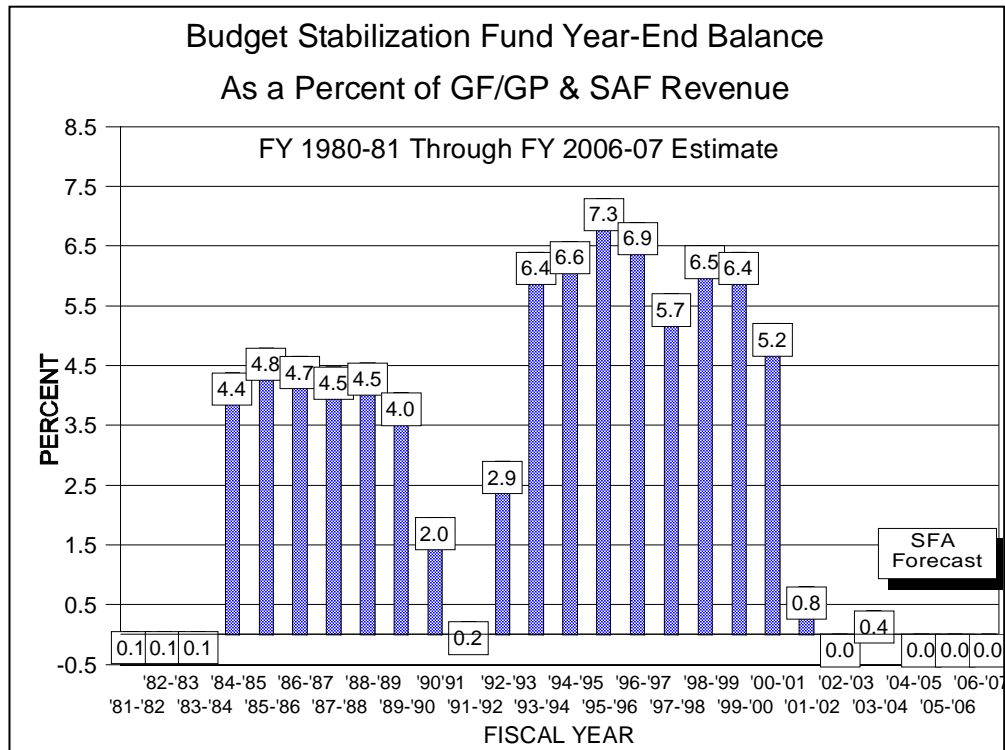


Table 9

ESTIMATED ECONOMIC AND BUDGET STABILIZATION FUND TRIGGER FY 2005-06 AND FY 2006-07 (Millions of Dollars)			
	CY 2005	CY 2006	CY 2007
Michigan Personal Income (MPI)	\$335,165	\$348,988	363,658
Less: Transfer Payments	51,756	56,076	59,763
Subtotal	\$283,409	\$292,912	\$303,895
Divided by: Detroit CPI, 12 months average ending June 30 (1982-84=1)	1.878	1.944	1.994
Equals: Real Adjusted MPI	\$150,910	\$150,675	\$152,405
Percent Change from Prior Year		(0.16)%	1.15%
Excess Over 2.0%		0.00 %	0.00%
		FY 2005-06	FY 2006-07
Multiplied by: Estimated GF/GP Revenue		\$8,261.2	\$8,128.4
Equals: Transfer to the BSF		\$0.0	\$0.0
OR Transfer from the BSF		\$12.9	\$0.0
Note: Numbers may not add due to rounding. CY = Calendar Year; FY = Fiscal Year			

COMPLIANCE WITH STATE REVENUE LIMIT

Article IX, Section 26 of the Michigan Constitution establishes a limit on the amount of revenue State government may collect in any fiscal year. This section of the Constitution was adopted by a vote of the people in 1978 and the limit was first applicable in FY 1979-80. In the first 15 years this revenue limit was in effect (FY 1979-80 to FY 1993-94), the revenue limit was never exceeded. In FY 1994-95, State revenue exceeded the revenue limit, for the first time, by \$109.6 million. This was due to the new State revenue being generated as part of the school financing reform that was enacted in 1994. In FY 1995-96, FY 1996-97, and FY 1997-98, revenue fell below the revenue limit again. In FY 1998-99 and FY 1999-2000, revenue exceeded the limit, but not by enough to require refunds to be paid to taxpayers. In FY 2000-01 through FY 2004-05, revenue fell well below the revenue limit. The largest gap between revenue and the limit occurred in FY 2003-04, when State revenue was \$4.4 billion below the revenue limit. Based on the SFA's latest economic forecast and revenue estimates, it is estimated that revenue subject to the revenue limit remained well below the revenue limit in FY 2005-06 and FY 2006-07.

THE REVENUE LIMIT

The revenue limit specifies that for any fiscal year, State government revenue may not exceed a certain percentage of Michigan personal income. The Constitution requires that the limit be calculated each year using the percentage that State government revenue in FY 1978-79 was of Michigan personal income in calendar year 1977. This calculation equals 9.49%. Therefore, for any fiscal year, State government revenue may not exceed 9.49% of Michigan total personal income for the calendar year prior to the calendar year in which the fiscal year begins. For instance, in FY 2004-05, State government revenue could not exceed 9.49% of personal income for calendar year 2003. Given that Michigan personal income for 2003 equaled \$314,460 million, the revenue limit for FY 2004-05 was \$29,842 million.

State government revenue subject to the limit includes total State government tax revenue and all other State government revenue, such as fees, licenses, and interest earnings. For purposes of the limit, State government revenue does not include Federal aid. Personal income is a measure of the total income received by individuals, including wages and salaries, proprietors' income, interest and dividend income, rental income, and transfer payments. It is the broadest measure of overall economic activity for the State of Michigan and is estimated by the U.S. Department of Commerce's Bureau of Economic Analysis.

REQUIREMENTS IF REVENUE LIMIT IS EXCEEDED

If final revenue exceeds the revenue limit, the Constitution and State law provide procedures to deal with this event. If revenue exceeds the limit by less than 1.0%, the excess revenue must be deposited into the Budget Stabilization Fund. If the revenue limit is exceeded by 1.0% or more, the excess revenue must be refunded to income tax and single business tax (SBT) payers, on a pro rata basis. These refunds would be given to taxpayers who file an annual income tax or SBT return in the following fiscal year, because these taxpayers would have made withholding and quarterly estimated payments during the fiscal year when the revenue limit was exceeded. The law requires that these refunds occur in the fiscal year following the filing of the report which determines that the limit was exceeded. This report for any particular fiscal year is typically issued in the spring following the end of the fiscal year.

REVENUE LIMIT COMPLIANCE PROJECTIONS

Based on preliminary information for FY 2004-05 and the SFA's revised revenue estimates for FY 2005-06 and FY 2006-07, it is estimated that revenue subject to the constitutional revenue limit will remain well below the revenue limit for each of these fiscal years. The SFA's estimates of the State's compliance with the revenue limit for FY 2004-05, FY 2005-06, and FY 2006-07 are presented in Table 10.

FY 2004-05

Based on preliminary information from the Department of Management and Budget, revenue subject to the revenue limit totaled an estimated \$25.6 billion in FY 2004-05. Based on Michigan personal income in calendar year 2003, the revenue limit equaled \$29.8 billion. As a result, revenue fell below the revenue limit by \$4.2 billion, or 14.1%, in FY 2004-05.

FY 2005-06

Based on the SFA's revised revenue estimates for FY 2005-06, it is estimated that revenue subject to the revenue limit will total \$26.1 billion. Michigan's personal income for 2004 produces a revenue limit for FY 2005-06 of \$30.8 billion. Based on these estimates for the revenue limit and revenue subject to the limit, it is estimated that revenue will fall below the limit by \$4.7 billion, or 15.2%, in FY 2005-06.

FY 2006-07

In FY 2006-07, the revenue limit will equal 9.49% of Michigan personal income for calendar year 2005 and, based on the SFA's revised economic forecast, the revenue limit will equal an estimated \$31.8 billion. Based on the SFA's revised revenue estimate for FY 2006-07, revenue subject to the limit will equal an estimated \$26.9 billion. As a result, it is estimated that revenue will fall short of the revenue limit by \$4.9 billion, or 15.5%, in FY 2006-07.

Table 10

**STATE'S COMPLIANCE WITH CONSTITUTIONAL REVENUE LIMIT
SECTION 26 OF ARTICLE IX OF THE STATE CONSTITUTION
(Millions of Dollars)**

	FY 2003-04 Final	FY 2004-05 Preliminary	FY 2005-06 Estimate	FY 2006-07 Estimate
<u>Revenue Subject to Limit:</u>				
Revenue:				
General Fund/General Purpose (baseline)	\$7,992.9	\$8,163.3	\$8,290.0	\$8,488.3
Revenue Sharing (baseline)	1,580.6	1,618.3	1,646.1	1,695.0
School Aid Fund (baseline)	10,533.6	10,914.9	11,172.1	11,524.1
Transportation Funds	2,279.3	2,215.9	2,238.7	2,330.4
Other Restricted Non-Federal Aid				
Revenue	1,899.5	2,609.5	2,750.0	2,900.0
Adjustments:				
GF/GP Federal Aid	(32.0)	(35.7)	(35.0)	(35.0)
GF/GP Balance Sheet Adjustments	49.3	145.5	(12.8)	(49.8)
SAF Balance Sheet Adjustments	81.5	(5.0)	25.2	25.2
Total Revenue Subject to Limit:	\$24,384.7	\$25,626.7	\$26,074.3	\$26,878.2
<u>Revenue Limit:</u>				
Personal Income:				
Calendar Year	CY 2002	CY 2003	CY 2004	CY 2005
Amount	\$303,745	\$314,460	\$324,134	\$335,165
Revenue Limit Ratio	9.49%	9.49%	9.49%	9.49%
Revenue Limit	\$28,825.4	\$29,842.2	\$30,760.3	\$31,807.2
1.0% of Limit	288.3	298.4	307.6	318.1
Amount Under (Over) Limit	\$4,440.7	\$4,215.5	\$4,686.0	\$4,929.0
Percent Below Limit	15.4%	14.1%	15.2%	15.5%

ESTIMATE OF YEAR-END BALANCES

Based on the economic and revenue estimates outlined earlier in this report, along with enacted and projected State appropriations, the Senate Fiscal Agency (SFA) has revised its estimates of the FY 2005-06 and FY 2006-07 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) year-end balances. This section of the report discusses the year-end balances, and addresses the issues that members of the Legislature are facing as they attempt to complete action on the FY 2006-07 State budget.

Table 11 provides a summary of the SFA's estimates of the FY 2005-06 and FY 2006-07 year-end balances of the GF/GP and SAF budgets. Based on the current SFA revenue estimates along with enacted and projected State appropriations, the FY 2005-06 GF/GP budget is in surplus by \$117.4 million. Based on the current SFA revenue estimates along with enacted State appropriations, the FY 2005-06 SAF budget is in surplus by \$88.1 million. Assuming the passage of the FY 2006-07 appropriations and tax policy changes as recommended by the Governor on February 9, 2006, the FY 2006-07 GF/GP budget is in surplus by \$78.8 million and the FY 2006-07 SAF budget is in deficit by \$36.3 million.

Table 11		
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND		
ESTIMATED YEAR-END BALANCES		
(Millions of Dollars)		
	FY 2005-06 Estimate	FY 2006-07 Estimate
General Fund/General Purpose	\$117.4	\$ 78.8
School Aid Fund	\$ 88.1	\$(36.3)

FY 2005-06 YEAR-END BALANCE

The current SFA estimates of the FY 2005-06 GF/GP and SAF budgets present a favorable picture for the balance of the fiscal year. With over 50.0% of the fiscal year completed, it now appears that a modest year-end balance will exist in both the GF/GP and SAF budgets. Under current statutory requirements, any FY 2005-06 GF/GP and SAF year-end balances will carry forward into FY 2006-07. The size of this carry-forward balance will be one of the key decisions to be made in finalizing action on the FY 2006-07 GF/GP and SAF budgets.

Table 12 provides a detailed summary of the SFA estimate of a \$117.4 million FY 2005-06 GF/GP budget surplus. This estimate of a year-end budget surplus is based on the current SFA revenue estimate, enacted revenue adjustments, enacted State appropriations, pending supplemental appropriations, and a projection of a modest level of year-end appropriation lapses.

On the revenue side of the FY 2005-06 GF/GP budget ledger, the SFA now believes that final GF/GP revenue will total \$9.1 billion. This projected level of FY 2005-06 GF/GP revenue represents a \$219.8 million or 2.5% increase over the final level of FY 2004-05 GF/GP revenue. The FY 2005-06 revenue total includes \$220.5 million of surplus GF/GP revenue carried forward from FY 2004-05, \$8.3 billion of ongoing estimated revenue, \$543.5 million of GF/GP revenue resulting from a statutory freeze in revenue sharing payments to cities, villages, townships, and counties, and \$101.0 million of revenue from non-ongoing sources that have been included in the enacted budget. The current SFA estimate of ongoing revenue represents a \$53.4 million increase from the January 2006 consensus revenue estimate.

Table 12
FY 2005-06
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	SFA Estimate
Revenue:	
Beginning Balance.....	\$ 220.5
Ongoing Revenue:	
Revenue Estimate	8,261.2
Revenue Sharing Adjustments	543.5
Subtotal Ongoing Revenues.....	8,804.7
Non-Ongoing Revenue:	
Interest Earnings Tobacco Securitization	6.0
Pharmaceutical Tax Credit Adjustment	10.0
Land Sales	47.0
Agriculture Equine Fund Transfer to GF/GP	2.0
Remonumentation Fund Transfer to GF/GP	15.0
Financial Institutions Fund Transfer to GF/GP	15.0
State Services Fee Fund Transfer to GF/GP	6.0
Subtotal Non-Ongoing Revenue.....	101.0
Total Revenue	\$9,126.2
Expenditures:	
Initial Appropriations	\$8,975.7
Supplemental Appropriations (P.A. 226 of 2005)	1.0
Supplemental Appropriations (P.A. 297 of 2005)	4.9
Supplemental Appropriations (P.A. 4 of 2006)	0.0
Supplemental Recommendation (S.B. 242 (S-5))	21.6
Tobacco Settlement Revenue Shortfall.....	25.6
Projected Appropriation Lapses	(20.0)
Total Expenditures	\$9,008.8
Projected Year-End Balance.....	\$ 117.4

On the expenditure side of the FY 2005-06 GF/GP budget ledger, the SFA now believes that final GF/GP expenditures will total \$9.0 billion. The FY 2005-06 expenditure total represents a \$322.9 million or 3.7% increase over the final level of FY 2004-05 GF/GP expenditures. The FY 2005-06 expenditure total includes \$9.0 billion of enacted appropriations, \$21.6 million currently pending in a supplemental appropriation bill, a projected \$25.6 million funding adjustment related to a shortfall in tobacco settlement revenue, and a projected \$20.0 million year-end appropriation lapse.

Table 13 provides a detailed summary of the SFA estimate of an \$88.1 million FY 2005-06 SAF budget surplus. This estimate of the year-end budget surplus is based on the current SFA revenue estimate, enacted revenue adjustments, enacted appropriations, and estimates of the final level of actual payments to local school districts.

On the revenue side of the FY 2005-06 SAF budget ledger, the SFA now believes that final SAF revenue will total \$12.8 billion. The FY 2005-06 revenue total represents a \$270.1 million or 2.2% increase over the final level of FY 2004-05 SAF revenue. The FY 2005-06 revenue total includes \$93.7 million of surplus SAF revenue carried forward from FY 2004-05, \$11.2 billion of ongoing estimated revenue, a \$62.7 million grant from the GF/GP budget, \$44.5 million of revenue from the enacted reforms in the School Bond Loan Fund program, \$3.0 million of receivable revenue from a prior fiscal year, and \$1.4 billion of Federal aid. The current SFA estimate of ongoing revenue represents a \$33.7 million decrease from the January 2006 consensus revenue estimate.

Table 13
FY 2005-06
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	SFA Estimate
Revenue:	
Beginning Balance.....	\$ 93.7
Ongoing Revenue Estimate.....	11,197.3
<u>Other Revenue Adjustments:</u>	
GF/GP Grant.....	62.7
School Bond Loan Fund Reform Revenue.....	44.5
FY 2003-04 Revenue Receivable.....	3.0
Federal Revenue	1,392.6
Subtotal Other Revenue Adjustments	1,502.8
Total Revenue	\$12,793.8
Expenditures:	
Enacted Appropriations	\$12,757.2
Adjusted Cost Estimates	(51.5)
Total Expenditures	\$12,705.7
Projected Year-End Balance.....	\$ 88.1

On the expenditure side of the FY 2005-06 SAF budget ledger, the SFA now believes that final SAF expenditures will total \$12.7 billion. This FY 2005-06 expenditure total represents a \$275.7 million or 2.2% increase over the final level of FY 2004-05 SAF expenditures. The FY 2005-06 expenditure total includes \$12.8 billion of enacted appropriations and a \$51.5 million adjustment to the final level of payments to school districts based on adjusted pupil counts, adjusted local property tax numbers, and adjusted estimates of special education payments to local school districts.

FY 2006-07 YEAR-END BALANCE

On February 9, 2006, Governor Granholm presented her recommendations to the Legislature for the FY 2006-07 GF/GP and SAF budgets. The Legislature is currently in the process of acting on these budget recommendations. This process is expected to be completed by June 30, 2006, with the enactment of the budget. The Governor's budget recommendations were based on the consensus revenue estimates agreed to in January 2006. The Governor's budget also included revenue generated from proposed tax and fee increases and included assumptions of FY 2005-06 projected year-end balances carried forward into FY 2006-07. Based on the current SFA revenue estimates and the Governor's overall budget recommendations, a balance exists in the FY 2006-07 GF/GP budget and the FY 2006-07 SAF budget is slightly in deficit. These estimates assume the carry forward into FY 2006-07 of the entire projected FY 2005-06 GF/GP and SAF year-end balances.

Table 14 provides a detailed summary of the SFA estimate of a \$78.8 million FY 2006-07 GF/GP budget surplus. On the revenue side of the FY 2006-07 GF/GP budget ledger, the SFA is now estimating total revenue of \$9.3 billion. This projected level of FY 2006-07 GF/GP revenue represents a \$211.6 million or 2.4% increase over FY 2005-06 revenue. The FY 2006-07 revenue total includes \$117.4 million of surplus GF/GP revenue carried forward from FY 2005-06, \$8.4 billion of ongoing GF/GP revenue, \$587.9 million of GF/GP revenue resulting from a statutory freeze in revenue sharing payments to cities, villages, townships, and counties, and \$198.0 million of other recommended revenue adjustments. These revenue adjustments include \$88.4 million from proposed tax policy changes, \$23.0 million from a proposed liquor license fee increase, \$28.0 million from the sale of surplus State land, and \$22.8 million of revenue from the SAF budget reflecting a proposal to have the SAF budget bear some of the cost associated with short-term cash flow borrowing. The current SFA

estimate of ongoing revenue represents a \$51.3 million increase from the January 2006 consensus revenue estimate.

Table 14
FY 2006-07
GENERAL FUND/GENERAL PURPOSE
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	SFA Estimate
Projected Revenue:	
Beginning Balance	\$ 117.4
Ongoing Revenue:	
Revenue Estimate	8,428.4
Revenue Sharing Freeze	587.9
Subtotal Ongoing Revenue	9,016.3
Governor's Recommended Revenue Adjustments:	
Pharmaceutical Tax Credit Adjustment	10.0
Land Sales	28.0
Financial Institutions Fund Transfer to GF/GP	2.8
Agriculture Equine Fund Transfer to GF/GP	2.0
State Services Fee Fund Transfer to GF/GP	6.0
Interest Earnings Tobacco Securitization	15.0
Tax Policy Changes	88.4
Liquor License Fee Increase	23.0
Shift of Short Term Borrowing Costs to School Aid Fund	22.8
Subtotal Governor's Recommended Revenue Adjustments	198.0
Total Estimated Revenue	\$9,331.7
Expenditures:	
Governor's Appropriation Recommendations	\$9,252.9
Projected Year-End Balance	\$ 78.8

On the expenditure side of the FY 2006-07 GF/GP budget ledger, the Governor's GF/GP appropriation recommendation totals \$9.3 billion. This represents a \$244.1 million or 2.6% increase over the projected level of FY 2005-06 expenditures. The projected \$78.8 million year-end balance in the Governor's FY 2006-07 budget recommendation provides the Governor and the Legislature some options in the negotiation of the final budget.

Table 15 provides a detailed summary of the SFA estimate of a \$36.3 million FY 2006-07 SAF budget deficit. This projected budget deficit results from a downward revision of the estimate of ongoing SAF revenue. On the revenue side of the FY 2006-07 SAF budget ledger, the SFA is now estimating total revenue of \$13.1 billion. This projected level of FY 2006-07 SAF revenue represents a \$311.7 million or 2.4% increase over FY 2005-06 revenue. The FY 2006-07 revenue total includes \$88.1 million of surplus revenue carried forward from FY 2005-06, \$11.6 billion of ongoing revenue, \$22.8 million from proposed tax policy changes, a \$35.0 million grant from the GF/GP budget, and \$1.4 billion of Federal aid. The current SFA estimate of ongoing revenue represents a \$44.2 million reduction from the January 2006 consensus revenue estimate.

On the expenditure side of the FY 2006-07 SAF budget ledger, the Governor's appropriation recommendations total \$13.1 billion. This represents a \$436.1 million or 3.4% increase over the projected level of FY 2005-06 expenditures.

Table 15
FY 2006-07
SCHOOL AID FUND
REVENUE, EXPENDITURES, AND YEAR-END BALANCE
(Millions of Dollars)

	SFA Estimate
Projected Revenue:	
Beginning Balance.....	\$ 88.1
Ongoing Revenue Estimate.....	11,546.9
<u>Other Revenue Adjustments:</u>	
Tax Policy Changes.....	22.8
GF/GP Grant at FY 2005-06 Level.....	35.0
Federal Aid at FY 2005-06 Level.....	1,412.7
Subtotal Other Revenue Adjustments	1,470.5
Total Estimated Revenue	\$13,105.5
Expenditures	
Governor's Appropriation Recommendations.....	\$13,119.0
Short-Term Borrowing Costs	22.8
Total Expenditures	\$13,141.8
Projected Year-End Balance.....	\$ (36.3)

FY 2006-07 KEY BUDGET DECISIONS

As the Legislature and the Governor move closer to final decisions on the FY 2006-07 budget, it appears that several key issues will have to be decided to ensure that the final FY 2006-07 GF/GP and SAF budgets are balanced between estimated revenue and enacted appropriations. These key decisions include:

FY 2005-06 Year-End Balances. The Governor's FY 2006-07 budget recommendation uses projected FY 2005-06 GF/GP and SAF year-end balances as revenue sources in the FY 2006-07 budgets. The final decisions on the FY 2006-07 budget will have to include a decision as to the amount of any FY 2005-06 year-end balances that are used in FY 2006-07. As an alternative to using the entire year-end balances to support FY 2006-07 appropriations, an option could be to deposit all or any portion of the FY 2005-06 year-end balances into the Budget Stabilization Fund.

Tax Policy Changes. The Governor's FY 2006-07 budget recommendation includes a total of \$111.2 million of increased GF/GP and SAF revenue from proposed tax policy changes. If the Legislature rejects these tax policy changes, corresponding appropriation adjustments will have to be made to ensure a balanced budget.

Fee Increase. The Governor's FY 2006-07 budget recommendation includes \$23.0 million of new GF/GP revenue from a proposal to increase the license fee for liquor license holders across the State. If the Legislature rejects this proposed fee increase, corresponding appropriation adjustments will have to be made to ensure a balanced budget.

Final Appropriation Targets. The final level of FY 2006-07 GF/GP and SAF appropriations likely will be made after decisions are finalized on the use of surplus funds carried forward from FY 2005-06 and the proposed tax and fee increases included in the Governor's budget recommendations. The final appropriation targets will be developed to ensure an enacted budget is balanced between estimated revenue and enacted appropriations.